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IN THE

Supreme Court of the United States,

OCTOBER TERM, 1927.

NO. [redacted] 4 4

UNITED FUEL GAS COMPANY,
Appellant,

vs.

THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA, BIRK S. STATHERS, ERNEST D. LEWIS, *et al.*

BRIEF ON BEHALF OF APPELLANT.

JOHN W. DAVIS,
HAROLD A. RITZ,
DOUGLAS M. MOFFAT,
EDWARD L. PATTERSON,
Counsel for Appellant.

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IN THE

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OCTOBER TERM, 1927.

UNITED FUEL GAS COMPANY, Appellant, vs. THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA, BIRK S. STATHERS, ERNEST D. LEWIS, *et al.*	No. 79

BRIEF ON BEHALF OF APPELLANT.

Prefatory Note.

This is an appeal from an order or judgment* of the District Court of the United States for the Southern District of West Virginia, dated May 10, 1926, denying the motion of the appellant for an interlocutory injunction enjoining, inhibiting and restraining the appellees, the Public Service Commission of West Virginia, and the members thereof from interfering with the appellant in putting in effect its increased rates for natural gas service, as filed with said Public Service Commission, and for other appropriate relief as prayed for in its bill (R., 24-6). The said order or judgment will be found at pages 1275-6 of the Record.

*So termed by the Court (R., 1275).

Opinion Below.

The opinion of the Court below is reported in 14 Fed. (2nd) 209, and also appears at pages 1230, *et seq.*, of the Record.

Jurisdiction of the Court.

This Court has jurisdiction of this appeal under Judicial Code, Sec. 266 (U. S. Code, Title 28, Sec. 380).

The specific claims advanced and rulings made in the lower Court which are relied on as the basis of this Court's jurisdiction, with a specification of such of the assigned errors as are intended to be urged, precede the Argument (p. 10, *post*).

In the language of the opinion of the lower Court (R., 1233):

> "Questions are raised, authoritative answers to which will affect public and private interests of far greater magnitude than those directly before us, considerable as the latter are."

History of the Case.

In the year 1917, appellant made an application to the Public Service Commission of West Virginia for authority to increase its rates for natural gas service. Provisional orders were entered in said proceeding from time to time allowing certain increases, and certain additional petitions were filed asking for additional increases, until finally, after observing the results of the provisional increases and provisional orders, the Commission, on February 20, 1923, entered an order granting an increase of five cents per thousand cubic feet for natural gas service (R., 161, *et seq.*). From this order of the Commission, the City of Charleston and other municipalities and other corporations, hereinafter referred to as the "protestants", prosecuted an appeal to the

Supreme Court of Appeals of West Virginia, which, on the 27th day of November, 1923, reversed the said order of the Public Service Commission and denied any increase in said rates. The Court's opinion is reported in 95 W. Va., 91; also in 120 S. E., 398.

A brief resume of the proceedings anterior to the filing of the later rate schedule involved in this case is contained in the opinion of the Court below herein (R., 1231).

The reversal by the Supreme Court of Appeals of West Virginia in the *City of Charleston* case, as will be found on examination of said opinion, was based on the conclusion that the evidence of value of certain items of this appellant's property (especially its gas properties, leaseholds and rights) was not sufficiently definite and certain to justify including those items of property in the rate base at anything more than their actual cost to it. The property referred to, as will hereafter appear, constitutes a very large part of appellee's assets, and the failure of the Court to include it at anything more than its actual cost so reduced the total value of the property that the Court found the existing rates to be compensatory. In that case, however, that Court did find that the Company was entitled to a rate which would furnish enough money to operate its business and give it a fair return on the present fair value of its property.

Upon the handing down of the opinion of the Supreme Court of Appeals, the appellant determined to have a complete appraisal and valuation of its property made by competent engineers and experts in order to overcome the criticism of its evidence by that Court, and also determined to support the evidence of such engineers and experts by the testimony of witnesses thoroughly familiar with the properties and with the natural gas business. To this end, it employed the well known firm of Ford, Bacon & Davis, who made an appraisal of the property as of December 31, 1923. It also employed Ralph E. Davis, a mining engineer and geologist admittedly of the highest standing, to make an

examination for the purpose of determining by approved scientific methods, as nearly as might be, the gas content of the properties owned and controlled by the appellant. On the completion of this appraisal by Messrs. Ford, Bacon & Davis, and of the work of Mr. Ralph E. Davis, a new schedule of rates was filed under the law with the Public Service Commission on April 25, 1924. This schedule is made Exhibit "B" with the Bill (R., 55, *et seq.*). Upon the filing of this schedule, the Public Service Commission, of its own motion, entered an order suspending the same, and set the case for hearing on May 28, 1924. On that date the appellant appeared and began the introduction of its evidence before the Commission, concluding the same about July 1, 1924. The case was then continued for several months upon the motion of the protestants, including the cities of Charleston and Huntington, for the purpose of allowing expert accountants and engineers employed by them to check the appraisement and inventories introduced by the appellant upon the hearing. After these experts had completed their work, the hearing was resumed and the case submitted to the Commission for decision. On March 24, 1925, it was decided by the Commission and the schedule of rates filed was cancelled (R., 1434), the Commission holding that the rates already in force were adequate to give appellant a fair return on the value of its property.

The Public Service Commission of West Virginia is composed of three members; each of whom filed a separate opinion. No two of them agreed as to the value of the Company's property, or as to the methods to be pursued in determining whether or not the rates proposed were fair and just. Two of said Commissioners, Chairman Stathers and Commissioner Divine, by separate processes, arrived at the conclusion that the proposed rates were too high, and that the rates then in force were adequate. Commissioner Lewis, the third member of the body, disagreed with this conclusion and was of opinion that the proposed schedule of rates

should have been approved. The opinion of Chairman Stathers will be found at pages 82, *et seq.* of the Record; that of Commissioner Divine at pages 134, *et seq.*, and that of Commissioner Lewis at pages 139, *et seq.*

The appellant thereupon filed the present bill in the District Court of the United States for the Southern District of West Virginia, seeking to enjoin the Public Service Commission of West Virginia from preventing the putting into effect of the rates filed by it, and to enjoin said Commission, as well as the law officers of the State of West Virginia, from enforcing the penalties provided by statute for the collection of the proposed rates. A special statutory court under Judicial Code, Section 266, was convened (R., 191), and after a complete and full hearing the case was submitted to it for decision May 18, 1925, upon the motion for a temporary injunction. The evidence consisted of the record before the Public Service Commission of West Virginia upon the said hearing before it which, by agreement of counsel and with the consent of the Court, was introduced with the same effect as though the witnesses had so testified upon the hearing before the latter, and of other evidence introduced in open Court. The latter, in the case of each witness, immediately follows in the printed record his testimony before the Commission. On May 10, 1926, nearly a year later, an opinion was handed down, written by Circuit Judge Rose and concurred in by District Judge McClintic, denying the temporary injunction. District Judge McDowell dissented from the majority but filed no opinion (Rec., pp. 1229, *et seq.*). The order appealed from followed.

Statement of Facts.

At the outset, it is well to call the attention of the Court to the fact that in this case, notwithstanding the mass of evidence taken on both sides, there is little or no dispute as to any matter of fact, the matters in controversy simply involv-

ing differences as to economic or legal theory. When a conclusion is reached as to which theory is the correct one, the case is necessarily decided. These may be left for statement as well as discussion under the appropriate points. In order to aid the Court in considering these opinions and theories, however, a brief description of the nature of the business in which the appellant is engaged seems in order.

Prior to the year 1909, indications had developed that parts of Southern West Virginia contained natural gas in paying quantities. This resulted in the acquisition of a large acreage in that territory by the Hope Natural Gas Company, which was then a large producer of natural gas in northern West Virginia, and also by United Fuel Gas Company, the predecessor of the appellant, and by the United States Natural Gas Company. In 1909, in order properly to develop said territory, the present United Fuel Gas Company acquired all of the leases and other property of the Hope Natural Gas Company in southern West Virginia, and all of the leases and other property of its predecessor, United Fuel Gas Company, and of United States Natural Gas Company. The gas leases and rights held by these companies were acquired at an agreed valuation of $6,732,920 (R., 561). The property thus acquired consisted of a small plant supplying gas to the City of Charleston, West Virginia, and some nearby communities, and the large gas acreage held by the above named predecessor companies, mostly under leases. These leases had been secured upon terms which were reasonably uniform, granting to the lessee the right to explore for and extract the oil and gas from the land.

Certain cash considerations were paid for the leases, the amounts being relatively small in the early days of the territory, and certain annual payments were agreed to be made to the land owner until oil or gas should be produced. After such production, by the terms of said leases, the land owner receives a proportion of the oil, the practically uniform pro-

vision being one-eighth thereof, and a certain annual rental, in most cases $300. per year, for each producing gas well. As a result of its purchase, appellant acquired in 1909 practically a million acres of this territory held under such leases.

Specimens of all of the forms of leases in ordinary use by the appellant are found at pages 1031-58 of the Record, and a statement showing the acreage operated and that as yet unoperated held under each such form of lease appears at pages 1014-30.

The development of the property on a much larger scale was then proceeded with, and it was discovered that natural gas was present in great quantities. Large sums of money were in consequence provided by the appellant and by its associated companies for the purpose of producing this natural gas and getting it to the market. In the organization, perfected in 1909, the Hope Natural Gas Company, which, as before stated, was a large producer of natural gas in West Virginia, became the owner of 51% of the stock of the appellant, and the Ohio Fuel Supply Company the owner of the other 49%. These companies provided the means for laying pipe lines from the gas fields to the markets in Pittsburgh, Columbus and other Pennsylvania and Ohio cities. In 1916 the Hope Natural Gas Company disposed of its holding in the appellant to the Columbia Gas & Electric Company. Prior to this time, however, that Company or one of its associates had constructed a pipe line from Cincinnati to the gas fields, and had been buying a large amount of gas from the appellant for the purpose of supplying the market at Cincinnati. The production of natural gas by the appellant increased very substantially from 1909 until it reached its peak in the year 1917, since which time the production has somewhat declined (R., 503). The ultimate exhaustion of the field is certain. In addition to producing natural gas in large quantities, appellant has also purchased very considerable quantities of gas from other producers in its field (R., 503).

In the beginning of production, the natural pressure of the gas in the well, commonly known as rock pressure, is sufficient to convey the gas through pipe lines for considerable distances. As the gas is extracted, however, from a particular pool, this pressure grows less and the distance to which gas can be transported by such pressure alone decreases. This makes necessary the construction of pumping or compressing stations, which pick the gas up when the pressure from the wells has become practically exhausted and force it again into the lines under very high pressure. This process is repeated as often as may be necessary to get the gas to the desired point under a pressure at which it can be distributed to the consumers. As will be observed from the recapitulation of the inventory of the Company's property filed as Uebelacker Exhibit No. 1 (R., 493, *et seq.*) there is a very large investment in pipe lines and compressor stations and other appliances used for the purpose of conveying the gas from the place of production to the place of consumption, referred to throughout the Record as the "transmission system". In fact, practically half of the plant used to produce the gas, convey it to the markets and distribute it to the consumers consists of these transmission lines, compressor stations and other appliances used purely for transportation purposes, while nearly an equal amount is invested in wells which have been drilled for the purpose of producing the gas from the sands in which the gas is contained (R., 537). Only a comparatively small part of the investment is in distribution plants in the various cities where the appellant furnishes gas to consumers (R., 538).

The customers of the appellant are divided into two classes, namely, (1) those to whom it sells gas delivered at the state line for transportation to other states at prices fixed by contract, including its two corporate stockholders; and (2) consumers for domestic and industrial purposes in West Virginia, to whom it sells at schedule rates, fixed by the Public Service Commission. Out of this grows the distinction to

which the Court below refers between its "regulated" and "unregulated" business. It also derives some revenue from the sale of the right to extract from the gas produced by it the gasoline carried in suspension.

Its markets are found in West Virginia, and in Kentucky through its subsidiary corporation Warfield Natural Gas Company (see *United Fuel Gas Company* vs. *Railroad Commission of Kentucky*, No. 19, submitted herewith); and because of these facts it becomes necessary, in determining the adequacy of its rates, first, to find the value of its entire property and then to allocate this value, as also its expenses and revenues, among the various services. The percentages to be utilized in making this allocation are not seriously in controversy (*post*, p. 52). When the basic facts are ascertained, the computation presents no difficulty.

The correct decision of this case involves, of course, several questions:

First: What is the value of appellant's property used and useful in the public service?

Second: To what rate of return is the appellant entitled upon this investment?

Third: To what amounts is it entitled for the purpose of compensating it for the gas distributed, for the purpose of depreciation in order that the plant may be kept in good condition, and what amount is it entitled to earn each year for the purpose of paying for the plant when the gas fields are exhausted and the property is no longer of value, generally referred to throughout the Record as amortization?

Fourth: What are the present earnings of the appellant from its public service business, and are they sufficient to provide funds for the above purposes?

Assignments of Error.

The District Court erred in denying the injunctive relief prayed for by the appellant. In so holding, it necessarily held:

(1) That appellant had not shown that the existing rates are confiscatory;

(2) That it had not shown that its property was confiscated by the order of the Public Service Commission of West Virginia complained of.

In so holding, it erred in the following respects:

(a) In holding that the value of the appellant's gas properties and rights properly to be included in the rate base did not exceed $10,317,311.39. The undisputed evidence established a far higher value.

(b) In holding that of appellant's gas properties and rights, only those classified as "proven" were used or useful in the public service.

(c) In holding, contrary to the undisputed evidence, that the value of appellant's tangible or physical property, including going concern value and working capital, was not more than $29,990,000.

(d) In failing to add to the value of said tangible or physical property as valued by it the sum of $2,044,778.24, being the cost of new investment in physical property, added and actually put in use in the public service during the year 1924, according to the undisputed evidence.

(e) In holding, contrary to the undisputed evidence, that 3.65% per year of the value of appellant's property was a proper allowance for amortization.

(f) In holding, contrary to the undisputed evidence, that the value of appellant's property devoted to the public service in West Virginia was not more than $11,251,499.

(g) In adding to the earnings of the appellant, as reflected by its books, the sum of $1,495,496.69 as additional compensation which it was held should have been charged to certain customers of the appellant for gas sold them in excess of the price actually charged and received.

(h) In charging appellant's earnings for 1923 with the sum of $934,393.41, as presumptive profit on the extraction of gasoline from the natural gas marketed by appellant, instead of the true amount earned by appellant from such gasoline extraction as reflected by its books.

The result of which errors and of each of them is to deprive appellant of its property without just compensation therefor, in violation of the 14th Amendment to the Constitution of the United States.

ARGUMENT.

Summary.

I. The value of appellant's property used and useful in the public service:

(1) The District Court erred in holding that the value of the appellant's gas properties and rights properly to be included in the rate base did not exceed $10,317,311.39. The undisputed evidence established a far higher value.

(a) *Appellant's evidence of value was adequate and complete.*

(b) *There was an entire absence of any contradictory testimony.*

(c) *Not cost, but present fair value, is the basis of return.*

(d) *The evidence before the Court met the previous criticisms by the Supreme Court of Appeals of West Virginia and of Public Service Commissioner Stathers.*

(e) *Neither the Commission nor the Court can disregard the uncontradicted testimony introduced by appellant.*

(2) The District Court erred in holding that of appellant's gas rights, only those classified as "proven" were used or useful in the public service.

(3) The District Court erred in holding, contrary to the undisputed evidence, that the value of appellant's tangible or physical property, including going concern value and working capital, was not more than $29,990,000.

(a) *Fair value of the inventory.*

(b) *Allowance for overheads.*

(c) *Allowance for depreciation.*

(d) *Going concern value.*

(4) The District Court erred in not including in the value of appellant's tangible or physical property the sum of $2,044,778.24, being new investment in physical property added and actually put in use in the public service during the year 1924, according to the undisputed evidence.

II. The said District Court erred in holding, contrary to the undisputed evidence, that the value of appellant's property *devoted to the public service in West Virginia* was not more than $11,251,499.

III. The said District Court erred in holding, contrary to the undisputed evidence, that 3.65% per year of the value of appellant's property was a proper allowance for amortization.

IV. It was error to add to the earnings of the appellant, as reflected by its books, the sum of $1,495,496.69 as additional compensation, which it was held should have been charged to certain customers of the appellant for gas sold them in excess of the price actually charged and received.

V. The said District Court erred in charging appellant's earnings with the sum of $934,393.41, as presumptive profit on the extraction of gasoline from the natural gas marketed by appellant, instead of the true amount earned by appellant from such gasoline extraction, as reflected by its books.

VI. The rates complained of in the bill are insufficient to produce a fair return on the value of appellant's property, and are therefore confiscatory.

VII. The order or judgment of the District Court should be reversed and this cause remanded with appropriate directions.

ARGUMENT.

I.

The value of appellant's property used and useful in the public service.

Both in point of legal principle and in mathematical weight, the most important questions presented by the Record are those of value. To segregate them it is necessary to call to mind the fact that appellant's property may be divided into two general classes—the first consisting of the gas territory owned and held by the appellant, and the second of the plant used for producing, transmitting and delivering natural gas to the appellant's consumers, sometimes termed herein its "physical" or "tangible" property.

The first class consists of more than 800,000 acres of land in which the appellant either owns the gas rights in fee, or holds the same under leases, giving it the exclusive right to produce the gas therefrom.

The second class consists of a large number of producing gas wells, extensive pipe line systems, compressing stations, distributing pipe lines, meters and a large number of other appliances and accessories used in connection with the business.

The Various Contentions as to Value.

The appellant maintains that the evidence shows that at a conservative estimate the value of its property, which should properly enter into any rate base, is as follows:

Physical property (production, transmission and distribution systems, etc.)	$22,274,274.00
Gas lands, leaseholds and rights	36,449,176.00
General overhead charges	6,357,046.00
New property added during 1924	2,014,778.00
Working capital	999,000.00
Going concern value (difference between reproduction cost new and same less deterioration)	8,423,105.00
Total	$76,538,379.00

Commissioner Stathers reached the following figures:

Physical property, Dec. 31, 1923 (R., 95)	$25,000,000.00
New property added, in service Nov. 30, 1924 (R., 95 6)	648,457.72
Gas leaseholds (R., 118)	6,361,511.42*
Working capital (R., 118)	990,000.00
Going value (R., 119)	3,000,000.00
Total (R., 119)	$35,999,969.14

Commissioner Divine, the following (R., 135):

Physical property, Dec. 31, 1923	26,000,000.00
Leaseholds, Dec. 31, 1923	10,500,000.00
Going concern value	3,000,000.00
Working capital	999,000.00
Additions to property in 1924	666,000.00
	$41,165,000.00

While the Court below held that the items in the rate base could not exceed:

*Note—Book cost $6,732,920 (R., 426, 561, 1166), which is the figure used by appellees' witness Hagenah in his valuation (R., 1166).

Physical property (R., 1247, 1266)	$26,000,000.00
Going concern value (R., *id.*)	3,000,000.00
Working capital (R., *id.*)	990,000.00
Gas reserves, used and useful in the public service (R., 1264, 1266)	10,317,311.39
	$40,307,311.39

It is apparent that the principal controversy arises in connection with the valuation of appellant's gas leaseholds and gas rights. It may properly be first discussed.

1. The District Court erred in holding that the value of the appellant's gas properties and rights properly to be included in the rate base did not exceed $10,317,311.39. The undisputed evidence established a far higher value.

As stated, the appellant owns the gas rights in more than 800,000 acres of land, situated in southern West Virginia and eastern Kentucky. Practically all these rights were acquired prior to 1909 before there was any substantial development in the southern West Virginia field for natural gas. From time to time since then additional acreage has been acquired, but it has been of little consequence as compared with the total acreage. This item of property was originally entered on the company's books at the amount paid therefor at the time of the company's organization in 1909, and before there was sufficient development fully to indicate its real value to wit, at the sum of $6,732,920; and this, the appellees contend, is the maximum amount which should be allowed as its value for rate-making purposes.

Commissioner Stathers has found in his opinion that there is no other competent evidence of value of this property. Commissioner Divine finds that there is no other evidence

whatever of weight as to the value of this property, but he thinks it should be appreciated to the extent that the Department of Commerce in its general index figures shows other property to have been appreciated in value, and thus he estimates the value of this property at $10,500,000.

No contention is made by anyone that this is all that it is worth or anything like its present value. Indeed the District Court says (R., 1262):

> "Doubtless as a whole, the rights are worth a good deal more than the plaintiff paid for them and they may approximate three times as much as the most they ever cost. For reasons to be presently stated we do not think we are called upon to make a definite finding on that question."

These reasons, when stated by the court, are that in its opinion, in which it differs with the Public Service Commission, only a fractional part of the appellant's gas rights are to be considered as used or useful in the Public Service, and for this fraction the valuation fixed by the appellant's witnesses may be adopted without disturbing its ultimate conclusion. Before discussing this phase of the matter it may be well to review the testimony.

a. *Appellant's evidence of value was adequate and complete.*

The appellant insists that the evidence establishes a present fair value for its gas properties of not less than $26,000,000 in round numbers.

For the purpose of proving the value of its gas properties appellant introduced the following witnesses:

Ralph E. Davis, a geologist and mining engineer of long and wide experience, whose qualifications appear at pages 229 *et seq.* of the Record, and who made a careful study of all this property. Mr. Davis had previously been employed by the appellant for the purpose of making a study of its

gas properties for the purpose of calculating depletion under the Federal Income Tax Laws. His evidence consists of his report, Vol. II of the Record, and of oral testimony which begins at page 229.

From this evidence it appears that he made a thorough study of all geological data available for the territory in which the lands lie. He studied the records of all gas wells drilled in that territory, both by appellant and by other gas producers. He ascertained the original production of each well, the initial rock pressure thereof, the amount of gas produced from each well from the beginning of production until the date of his report, and the same data as to each field or pool. He observed the decrease of rock pressure in each well and in each pool as the gas was taken therefrom. He noted the geological location of each well, studied the territory adjacent thereto and from these observations determined the number of acres of land proven to be productive of natural gas within each of the various pools which had been tested. Certain of appellant's acreage amounting to a total of 136,384 acres, he classified as "proven"; that is, territory which had been actually proved by the successful driving of wells to be underlaid with natural gas. Other portions of the territory, totalling 126,208 acres, he classified as "probable"; that is, located within what he found to be the same pools as those underlying the "proven" acreage but within the limits of which no wells had as yet actually been drilled. In view of the fact that this "probable" territory had not been actually demonstrated to be productive of gas he deducted from its estimated content certain percentages varying as to different pools or tracts of land, but averaging as to all of them 38% (R., 261).

The balance of Appellant's acreage, a total of 552,318.68 acres, this witness classifies as "possible" or "unfavorable" (R., 239-240) for the reason that at the date of his examination and report drilling had not so far progressed therein as to permit of any reasonable estimate as to the quantity

of natural gas which it contained. In his estimate, presently to be mentioned, of the amount of gas underlying plaintiff's acreage he therefore entirely excluded this territory (R., 242).

Having thus determined the number of "proven" and "probable" acres, he next proceeded to determine the quantity of gas in the various pools. This he did by comparing the initial rock pressures and the rock pressures at the time of his examination by dividing the total number of cubic feet of gas produced from each pool by the decrease in rock pressure in pounds and ascertained the number of thousands of cubic feet of gas produced from the pool for each pound of decrease of rock pressure. Then, by multiplying this factor by the initial rock pressure, he determined the quantity of gas in the pool originally, and by multiplying it by the rock pressure at the time he made his observation he determined the amount of gas still remaining therein. The method pursued by him in reaching these conclusions and the reasons therefor are fully set forth in his report and testimony above cited.

To test the accuracy of his calculations he applied the same method to the past history of the various pools and wells (R., 734). He found that by taking the decrease in rock pressure from the beginning up to 1913 and applying it to the number of cubic feet, which should, according to his calculations, have been produced for each pound of rock pressure, he had a result which differed only about 6% from the amount of gas actually produced by the company during that period from those pools and wells, the actual production being in excess of the calculated production to that extent. This demonstrates both the reliability of his methods and the conservatism of his estimate.

This witness was cross examined on December 29, 1924, about seven months after he had testified, and a year after he had made his classifications and estimates above referred to. In the intervening time a number of wells had been

drilled, and the witness instances on redirect examination (R., 272) one case in which ten wells were drilled in the Clendenin pool, eight in the territory which he had classified as "probable" and two in territory classified by him as "unfavorable". Of these ten wells three were oil producing wells and seven gas producing wells, the two in the "unfavorable" territory being gas producing wells.

It appears from Mr. Davis's testimony and report that the method so adopted by him for calculating the content of natural gas pools is one which is now generally approved, and is the one used by the engineers of the United States Government in determining depletion for income tax purposes. Large gas interests are guided to a material extent thereby, and it has been applied for a sufficient length of time to actual conditions to demonstrate its practical value (R., 241).

As a result of his study and calculations the witness estimates that in the "proven" territory of 136,384 acres there remained as of the date to which his report refers 249,100,000,000 cubic feet of natural gas unextracted, and in the "probable" territory of 126,208 acres 414,600,000,000 cubic feet, a total of 663,700,000,000 cubic feet (R., 737).

This witness (Ralph E. Davis) further testified that he made a comparison of the value of natural gas and coal in the manufacture of steel and found that at the date of his testimony natural gas was worth at least 35 cents per thousand cubic feet, when in competition with a good grade of soft coal (R., 244).

He supplemented this study by actual inquiry among many large consumers of natural gas, including steel companies at Pittsburgh, and found that the price they were paying was in the neighborhood of 35 cents per thousand cubic feet, one steel company using several million feet a day at that price (R., 244-5).

Finding this market adequate to absorb the product of the United Fuel Gas Company, he then calculated the cost of

getting the gas to this market, providing for the construction of pipe lines, and found that it would require, including therein the value of property and land already owned by the company, a plant of the value of $52,181,538 (R., 246). He then found that the gas would pay for this plant, a fair return upon the investment, including taxes and all other expenses, and leave $34,659,936.18 as the value of the gas. (See his Exhibit "Z", R., 959, and table, R., 980.) Examination of this report and Exhibit "Z" shows that he has included every item of expense and has applied the proper discount factor in arriving at his conclusion.

Said the court below (R., 1255):

> "His testimony stands uncontradicted."

Charles F. Uebelacker, of the firm of Ford, Bacon & Davis above referred to, who has investigated and reported on some thirty-six natural gas companies, and whose other exceptional qualifications appear at pages 195, *et seq.* of the record, assumed as correct the quantity of gas found by Mr. Davis to be available as aforesaid. He then took several representative contracts under which gas was being sold in the field, in no wise affected by public regulation, and assumed that the company's gas would be worth as much as the gas sold under these contracts, less what it cost the company to produce it with its own wells. He made a very careful calculation of the cost of producing gas by the company's own wells, and found that it cost 5.431 cents per thousand cubic feet. The method used by him is fully discussed in his report (R., 520-525). He states the governing principles as follows (R., 521):

> "The measure of the value to the owner or lessee of gas in the ground is the difference between the prevailing market price at which such owner or lessee can purchase gas delivered to the field mains and the cost to such owner or lessee of producing and maintaining with his own wells an equivalent supply of gas at the same point of delivery.

"In applying this principle it is necessary to arrive at:

(a) The total cost to the owner or lessee of producing and maintaining with his own wells and equipment an equivalent supply of gas corresponding in delivery conditions to those under which the gas is purchased. This total cost must include operating expenses and depreciation, amortization of the value of the equipment used and a fair return upon the investment in such equipment.

(b) The prevailing market price at which gas can be purchased as controlled by delivery conditions.

(c) The estimated recoverable content of the proven and probably productive acreage."

Applying these factors to the total amount of gas which Mr. Davis found to be in the "proven" and "probable" acreage produced a value of this gas of $43,155,421.55 (R. 535). The remaining acreage, to wit, 552,319, in respect of which Mr. Davis made no estimate as to the quantity of gas in the ground, Mr. Uebelacker valued at the average price for acquiring acreage in the year 1923, $5.9655 per acre, giving to this acreage a value of $3,293,754, or a total valuation for gas land, leaseholds and natural gas rights of $36,449,176, which is the first item carried into his table at page 537 of the record. The contracts which Mr. Uebelacker took as typical were, as appears from his report just referred to, entirely independent contracts for the sale and purchase of large quantities of natural gas made by parties dealing at arm's length and without the intervention of any public regulating authority.

James J. Calot, who testified (R. 319) that he was the manager of a gas company which produced considerable quantities of gas; that he had an offer from a purchaser whom he named to purchase the gas produced by his company at 14 cents per thousand cubic feet at the mouth of the well after the gasoline had been extracted therefrom, which offer he had declined as too low.

Ira G. Sayre, another independent producer, who testified (R., 321) that he was selling the gas produced by him to Owens Bottle Company, after extracting the gasoline, at 10 cents per thousand cubic feet, and that he had made other sales at from 12 to 15 cents per thousand cubic feet; that the contract with the Owens Bottle Company was made about three years before the date of his testimony; that the price of gas had not decreased since, and that he did not expect to renew said contract at that price when it expired.

Ben C. Grosscup, who testified (R., 323) that he was vice-president and general manager of the Charleston-Dunbar Natural Gas Company; that he purchased large quantities of gas for his company, and that the price paid by him for such gas in the two years last past varied from 9 to 12 and 14 cents at the mouth of the well.

J. C. Blair, who testified (R., 360) that a company with which he was associated was then selling all its gas under a contract with International Nickel Company delivered at Huntington, West Virginia, at the end of an 8 inch pipe line, costing about 2.8 cents to deliver; that the price under this contract at the date of his testimony was 20 cents per thousand cubic feet, rising to 23 cents in two years and to 25 cents two years thereafter; that under this contract his company had the right to extract the gasoline before delivering the gas; that he had bought gas in the field on a six-year contract at 12 cents a thousand feet for the first three years and 15 cents for the remaining three years.

H. A. Wallace, vice-president and general manager of the appellant, who testified (R., 349) that during the last year before the date of his testimony he had made contracts to purchase gas from small producers in the field, that under the last contracts which he then recalled he paid 15 cents a thousand feet for the gas at the wells, besides agreeing to spend approximately $120,000 in laying pipe lines and giving to the other party with whom he contracted what he considered practically 1000 acres of proven gas or oil territory.

Further (R., 355) that he was advised of contracts which the Hope Natural Gas Company was then making in the field for the purchase of gas at 18 cents per thousand cubic feet, the quantity involved being possibly two or three million feet daily.

T. O. Sullivan, vice-president and general manager of the Hope Natural Gas Company, who testified (R., 2834) that his company purchased gas from other producers in the West Virginia field at the well and paid from 10½ to possibly 14 or 16 cents per thousand feet therefor, the price varying according to the place of delivery.

The testimony of these actual operators and dealers in natural gas corroborates Mr. Uebelacker. As stated, these contracts were all between parties dealing at arm's length, independently of any public regulating body, and indicate in the strongest manner that Mr. Uebelacker's calculation of the value of the gas in the ground is most conservative.

Appellant also produced another class of witnesses, consisting of a number of men prominent in the natural gas business, of long experience therein, associated with companies doing a very large business and having in addition peculiar knowledge of the gas fields in which appellant's acreage is located, all of whom had made independent valuations thereof. These witnesses are as follows:

T. O. Sullivan, at the date of his testimony, vice-president and general manager of the Hope Natural Gas Company (R., 279, *et seq.*). In addition to his testimony cited above, and after demonstrating his profound knowledge of the subject matter through his connection with large producing natural gas companies in West Virginia and western Pennsylvania since 1886, he proceeded to show his familiarity with appellant's gas acreage and its records of production (R., 281). He expressed the opinion, based on his personal knowledge, experience and examination, that the value of appellant's gas reserves was in round figures $34,000,000; that he considered

that a prudent purchaser ought to be willing to pay a willing seller that sum therefor; that in his judgment, based on his practical experience, appellant's operations upon said territory had "been very wisely conducted in order to develop the property to the greatest extent with the fewest number of wells"; that he had been operating similar properties under substantially the same conditions for twenty years; that appellant's acreage is a peculiarly valuable property because of the fact that it is well joined up, resulting in the production of gas at a minimum cost because of non-necessity for drilling offset wells and the absence of interference through operations on adjoining tracts; that in arriving at his valuation of appellant's gas acreage he had in mind the sale of the gas in a free market where the price would not be affected by the rates prescribed by public authorities, such markets existing in Pennsylvania and Ohio; that in fixing his valuation he did not consider any value which the gas might have had for the extraction of gasoline, and that if the gas has any additional value for that purpose, his valuation would be increased to that extent. That he was familiar in a general way with appellant's plant, and that, assuming it to be worth $25,000,000, in his judgment *a company would not be justified in making the investment that has been made in that plant without a large reserve gas acreage, that the reserve acreage which the company has is not any too much and is not large enough if other desirable acreage can be secured.*

John B. Corrin, vice-president of the Hope Natural Gas Company, who qualified (R., 284) by detailing his experience for twenty-two years in the natural gas business, his previous experience in the oil business and his connection with companies whose operations are comparable in size with those of appellant, and who showed his peculiar knowledge of the properties of appellant by reason of the fact that a large part of them had formerly been held by the Hope Natural Gas Company and sold by it to appellant. In his opinion, based upon his study of all

the elements that should enter into a judgment as to the value of such property, access to all of the company's records, knowledge of the number of its wells, the amount of gas produced, the initial rock pressures of the wells, present rock pressures, and all other material data, the value of appellant's gas properties in West Virginia alone (R., 287-8) was at least $35,000,000. He based his valuation in part upon what he considered the unquestionable fact that appellant's entire output could be sold for industrial purposes in Ohio and Pennsylvania free from any control by any public authority. He further testified as to his acquaintance with appellant's physical plant and stated as his judgment that, upon the assumption that such plant cost $25,000,000, *its construction would not be justified unless there was behind it at least as much reserve acreage as appellant has or more* (R., 289).

An affidavit by this same witness (Corrin), filed upon the hearing before the court (R., 290), brings out the fact that his valuation of appellant's gas properties as above was based upon full knowledge that most of them were leaseholds and that he had before him full details respecting the leases. It is thought that this, supplemented by appellant's other evidence on the subject referred to at page 35 hereof, fully meets the criticism of Commissioner Stathers (R., 112) that none of appellant's witnesses showed any familiarity with any of the leases or testified in relation thereto.

T. B. Gregory, president and director of a number of natural gas and oil companies, after (R., 292, *et seq.*) demonstrating his thorough familiarity with the natural gas business resulting from forty years' experience, his familiarity with appellant's properties and his study thereof, both in the service of his own companies and as director in charge of gas for the United States Fuel Administration during the recent war, placed a valuation upon appellant's West Virginia property, excluding the production plant and the transmission plant, in excess of $30,000,000. He testified that he

would willingly give $5,000 for a sixty day option at that figure on the West Virginia reserve gas property alone without taking into consideration the value of any gasoline which it might yield and expressed certainty of his ability to finance the handling of the property at that price (R., 295). In examination of this witness before the court it was clearly brought out (R., 296-7) that he was thoroughly familiar with the nature of appellant's rights and interests in its so-called gas reserves and formed his opinion as to their value accordingly. Like the witnesses Sullivan and Corrin, he was strongly of the opinion that the erection of appellant's production and distribution plant would not be justified unless there was behind it as much or more acreage as that of appellant and that the latter would be very lax if it did not acquire additional acreage if possible (R., 296).

On cross examination it was brought out that the valuation of this witness was based in part upon the fact that natural gas could be sold in Pittsburgh as well as in Columbus at 55 cents or more per thousand cubic feet.

A. G. Wamock (R., 303) and John Davidson (R., 306), both experienced operators and large producers of natural gas in the field in which appellant's acreage is situated, placed valuations upon appellant's gas acreage of $45,000,000 and $31,200,000 (R., 318) respectively.

S. W. Meals, president of the Carnegie Natural Gas Company, who testified (R., 304-6), after showing his familiarity with the subject, that manufacturing industries in Pittsburgh were paying at that time 45 cents per thousand cubic feet for natural gas.

It is suggested in the opinion of the court below (R., 1261) that these witnesses of the last class are interested in the natural gas business and are for that reason disposed to place excessive values on natural gas properties. The Court admits that "they are all highly competent men", but proceeds: "Perhaps it would not be unnatural to suspect that they are inclined to think well of properties similar to that

of which they are part owners." Why should they not be? They have been exercising their judgment as to such properties for many years, and their companies are all highly successful.

This method of proving the value of such gas properties as appellant's had the express approval of the Court in *Pennsylvania Gas Co.* vs. *Public Service Commission*, 211 App. Div. (N. Y.) 253, 262 3.

It is submitted that there is no basis for the Court's criticism of these witnesses, and no attack was made upon their testimony by the appellees upon this ground. The only objection to their testimony which the record contains is that the witnesses, Sullivan and Corrin, did not show themselves competent to express an opinion as to the value of appellant's gas rights (R., 284, 287, 290). This objection is, of course, without merit, and was so considered by the Court, as appears from its language just quoted. It is obvious that a reliable opinion as to the money value of such property as appellant's gas holdings is scarcely to be had except from those interested in and experienced in the same business. These witnesses were all men of the highest standing and none of them had any connection with the appellant. If such men as Messrs. Sullivan, Corrin and Gregory are not qualified to express an authoritative opinion upon the value of such properties as that under discussion, there is no competent witness upon the subject. Coming back to the question of their suggested bias, it is submitted that such men are no more likely to be biased than engineers and accountants whose principal business is testifying for municipalities and public service Commissions.

We have here testimony which would be perfectly competent to prove the value of this property if it was sought to condemn it for any public purpose or to prove its value for any other purpose for which it might be necessary to determine the same, but it is urged that some other or different character of proof must be offered when we come

to show the value for rate-making purposes. The nature of such different or additional proof is, however, not suggested. Value for purposes of rate making is no other or different from value for purposes of purchase or condemnation in the exercise of the power of eminent domain. Evidence which is competent and adequate in the one case is equally so in the other, and it is not true that a rate case requires some other character or quantity of proof peculiar to itself.

> *City of Erie* vs. *Public Service Commission of Pennsylvania*, 278 Penn. 512, 123 Atl. 471, 477.

But the testimony of these witnesses finds its strongest support in the fact that no attempt whatever was made by the appellees to controvert it.

> *Ibid., loc. cit.;*
> *Pennsylvania Gas Company* vs. *Public Service Commission*, 211 App. Div. (N. Y.) 253, 262 3;
> *People* ex rel. *Peoples Gas & Electric Co.* vs. *Public Service Commission*, 214 App. Div. (N. Y.) 108, 112 3.

This aspect of the case we proceed to discuss.

b. ***There was an entire absence of any contradictory testimony.***

To meet appellant's evidence as to the value of its gas rights and properties, appellees introduced *nothing* except the evidence of the amount paid by the company for the acreage in the beginning, and a statement made up by an expert accountant as to the average cost of renewing leases. This evidence of the cost of renewal is of no particular force, as appears from the testimony of Dillon C. Jay (R., 372), for the reason that appellant has the right to perpetuate its leases by drilling wells on the leased property, and when it applies for a renewal a year or eighteen months before the expiration of the term, the landowner knows that unless he

renews a well will be drilled and the lease perpetuated. For this reason renewals are secured upon very reasonable terms.

It is apparent that the evidence of the value of this property which the majority of the Public Service Commission considered as the only competent evidence thereof is its cost long before the rise in prices (R., 117-136), and at a time when development had not proven the value of the property for natural gas production. This evidence, as this court has so recently said in *McCardle* vs. *Indianapolis Water Co.*, 272 U. S. 400, 410, is of little weight in determining the question of value. The court in that case said that the cost of the plant or the cost of property acquired prior to the great rise in prices due to the war does not constitute any real indication of the value of the property at the present time.

We submit that, instead of taking the most reliable evidence as to value, the Commission attributed exclusive weight to the least reliable evidence thereof. Upon this theory that the cost of the gas rights was the proper evidence of value, Commissioner Stathers fixed a value of $6,361,511.42 therefor. No contention is made by any of the experts for the appellees or the Commission that this is anything like the present value of the property. Appellant has supported the valuation which it claims for its gas properties in three ways: (1) by the testimony of an expert geologist and engineer thoroughly conversant with the latest developments and the practical working of the theory upon which he relies, (2) by evidence as to the actual price paid for natural gas under contracts between parties wholly independent of each other and contracting independently of public regulation, and (3) by the opinions of men of the highest standing in the natural gas business, men of great experience, and, moreover, well acquainted with the particular property in respect of which their opinions are expressed. The record shows that after these witnesses testified the court gave the protestants several months to get additional evidence, but not a single witness was produced at the end of that period to controvert the appellant's witnesses or to suggest that their judgment was not entitled to absolute credit and the utmost weight. If

the protestants had been able to find any witnesses whose testimony could have tended to impeach that of appellant's, it is inconceivable that such witnesses would not have been produced.

c. *Not cost, but present fair value, is the basis of return.*

In arriving at a rate base, the matter to be determined is not the original cost of the property constituting it, or what the present owner paid for it (if it was bought as a going concern), but what it is worth as a going concern at the time the inquiry is being made. This Court has so often and so clearly asserted this proposition that it would seem a work of supererogation to discuss it here but for the fact that the Public Service Commission and Court below have departed so far in this case from the proper criterion. We therefore call attention to a few of the decisions.

In *Minnesota Rate Cases*, 230 U. S. 352, the Court at page 454, very clearly declares this principle:

> "It is clear that in ascertaining the present value, we are not limited to the consideration of the amount of the actual investment. If that has been reckless or improvident, losses may be sustained which the community does not underwrite. As the company may not be protected in its actual investment, if the value of its property be plainly less, so the making of a just return for the use of the property involves the recognition of its fair value if it be more than its cost. *The property is held in private ownership and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law.*" (Italics appellant's.)

In *Board of Commissioners* vs. *New York Telephone Company*, 271 U. S., 23, this court, at page 31, said:

> "The just compensation safeguarded to the utility by the Fourteenth Amendment is a reasonable return on the value of the property used at the time that it is being used for the public service, and rates not sufficient to yield that return are confiscatory."

Similar language was used by the Court in *Bluefield Water Works & Improvement Company* vs. *Public Service Commission of West Virginia*, 262 U. S., 679, at page 690. In that case the Court also quoted from the opinion in *Willcox* vs. *Consolidated Gas Company*, 212 U. S., 19, 52, the following:

> "And we concur with the Court below in holding that the value of the property is to be determined as of the time when the inquiry is made regarding the rates. If the property which legally enters into the consideration of the question of rates has increased in value since it was acquired, the Company is entitled to the benefit of such increase."

In *Ohio Utilities Company* vs. *Public Utilities Commission of Ohio*, 267 U. S., 359, at page 363, the Court comments upon the curtailment of the estimated value of buildings by the small sum of $266.17, and says that such curtailment "finds no explanation in the record, and probably was a sacrifice to the easy convenience of round numbers". This comment might be applied with peculiar propriety to the conclusions reached by the majority of the Public Service Commission and by the Court in this case, for most of their values are found in even millions, a result hardly to be expected if all of the evidence had been considered in ascertaining such values.

This doctrine of present fair value as the thing to be sought is reiterated by this Court in the very recent case of *McCardle* vs. *Indianapolis Water Company*, 272 U. S., 400, in which the Court discusses to some extent the weight to be given of cost of construction. It says (p. 410):

> "It is well established that values of utility properties fluctuate, and that owners must bear the decline and are entitled to the increase. The decision of this Court in *Smyth* vs. *Ames*, 169 U. S. 466, 547, declares that to ascertain value 'the present as compared with the original cost of construction' are, among other things, matters of consideration. But this does not

mean that the original cost or present cost or some figure arbitrarily chosen between these two is to be taken as the measure. The weight to be given to such cost figures and other items or classes of evidence is to be determined in the light of the facts of the case in hand. By far the greater part of the company's land and plant was acquired and constructed long before the war. The present value of the land is much greater than its cost and the present cost of construction of those parts of the plant is much more than their reasonable original cost. *In fact, prices and values have so changed that the amounts paid for land in the early years of the enterprise and the cost of plant elements constructed prior to the great rise of prices due to the war do not constitute any real indication of their value at the present time.*" (Italics appellant's.)

The doctrine thus laid down by this Court was recognized by the Supreme Court of Appeals of West Virginia as binding upon it in a case involving the value for rate making purposes of these very properties, although that Court held that in that particular case the evidence of appreciation of values over investment was insufficient.

> *City of Charleston* vs. *Public Service Commission*, 95 W. Va. 91; 120 S. E. 398, 403.

But the evidence in the instant case fully meets the criticisms so made by the Supreme Court of Appeals of West Virginia upon that before it in the case cited.

(d) *The evidence before the Court met the previous criticisms by the Supreme Court of Appeals of West Virginia and of Public Service Commissioner Stathers.*

As stated, the Supreme Court of Appeals of West Virginia in *City of Charleston* vs. *Public Service Commission*, 95 W. Va. 91; 120 S. E. 398, while bowing to the authority of this Court as to the principle laid down in the decisions which we have cited, held that the evidence then before it was too spec-

ulative and uncertain to show the appreciation of value over investment (120 S. E. at p. 403). As stated above (p. 3), it was for the purpose of meeting this criticism that appellant retained Mr. Uebelacker to make the appraisal of its property and caused Mr. Davis to continue his investigations. The testimony of Mr. Davis in the instant case is therefore much more full and circumstantial than it was in the *City of Charleston* case, he having in the meantime had opportunity to make a much more thorough examination. It further appears that Mr. Davis's method of estimating the quantity of gas in the ground was more widely accepted at the date of his testimony in the instant case than it was at the date of his testimony before the Public Service Commission in the *City of Charleston* case (R., 240-2, 247, 256-7). As an instance of this, he cites the fact that in the interval between the two dates the Engineering Division of the United States Bureau of Internal Revenue has recognized his method as essentially sound and accepted the reports prepared in accordance therewith for the purpose of allowing depletion (Rec., 240). Mr. Uebelacker's testimony supporting that of Mr. Davis was also absent in the *City of Charleston* case. Nor was there introduced in that case any such testimony as was given in this by the witnesses Sullivan, Corrin, Gregory, Davidson and Wamock—men of great practical experience in the natural gas business and thoroughly competent judges of the market values of natural gas properties.

Chairman Stathers admits (R., 114-5) that appellant's gas leaseholds have a value which, including appreciation since their acquisition, must, if shown, be included in the rate base. In declaring that the leaseholds have value he is in entire accord with the decisions of this Court, which has made similar rulings as to leases conferring the right to remove and reduce ore deposits, and as to water rights.

Lynch vs. *Alworth-Stephens Co.*, 267 U. S. 364, 369;

San Joaquin County vs. *Stanislaus County*, 233 U. S. 454, 459;
McCardle vs. *Indianapolis Water Co.*, 272 U. S. 400, 413.

He takes the ground, however (R., 99) that Mr. Uebelacker has not endeavored through investigation of values in the neighborhood in which these leaseholds are located, to make any estimate of their market value and that no other witnesses of appellant have given this acreage any valuation. Mr. Stathers evidently lost sight of the testimony of the witness Sullivan (R., 283), Corrin (R., 286), and Gregory (R., 294), from which it clearly appears that these witnesses were placing a value upon the particular leaseholds that appellant owned and upon nothing else, and that they were fully acquainted with the exact nature of appellant's interest in the property. Mr. Corrin reiterates this in the most specific manner in his affidavit introduced in the hearing before the Court (R., 291).

Mr. Stathers makes the further criticism (R., 108) that the form of lease or contract in use by the appellant was not introduced before the Commission. This omission was fully supplied by the introduction before the Court of specimens of all the forms of leases in common use by appellant (R., 1031-1058), with a tabulation of the acreage held under each such form (R., 1014-1030).

(e) *Neither the Commission nor the Court can disregard the uncontradicted testimony.*

The testimony of witnesses whose character is unimpeached and which is not shown to be mistaken or inaccurate, either on cross examination or by counter-testimony, cannot be arbitrarily discarded. There must be some basis in the Record to justify disregarding it and we submit that there is no such basis in this Record.

Ohio Utilities Co. v. *Public Utilities Commission of Ohio*, 267 U. S., 359, 362-3;

Quock Ting vs. *United States*, 140 U. S. 417, 420;

City of Erie vs. *Public Service Commission of Pa.*, 278 Penn., 512; 123 Atl., 471, 477;

Pennsylvania Gas Company vs. *Public Service Commission*, 211 App. Div. N. Y. 253, 262-3.

"A finding without evidence is beyond the power of the Commission."

Interstate Commerce Commission v. *L. & N. R. R. Co.*, 227 U. S. 88, 92-3;

Florida East Coast R'way Co. v. *U. S.*, 234 U. S. 167, 185.

2. The District Court erred in holding that of appellant's gas rights only those classified as "proven" were used or useful in the public service.

As we have stated, the Court below escaped the task of finding the fair value of appellant's gas rights by striking out on a line of its own. After discussing the evidence of value before it, it abandoned the Public Service Commission's point of view and came to the conclusion (R., 1262-4) that only so much of this gas property was used and useful in the public service as had been actually demonstrated by drilling to contain natural gas, being the 136,384 acres which Mr. Davis classifies as "proven" acreage, and upon which he fixes a value of $10,317,311.39. This value the Court adopts and argues that while the rest of the property may be valuable, it cannot be considered as being so for the public service. In this it differs also with the Supreme Court of Appeals of West Virginia which, in the case of *City of Charleston* vs. *Public Service Commission*, 95 W. Va. 91, 120 S. E. 398, had under consideration the valuation of the

same gas rights for rate-making purposes, and concluded that the appellant was entitled to earn a fair return upon the present fair value of all these gas reserves. This is the latest pronouncement of the highest Court of the State on this subject, and in addition relates to this particular property. It is true in that case the Court held that the evidence then before it was not sufficient to prove any value of the gas rights over their cost, but it unequivocally held that if such value was proved then it must be allowed. The opinion of the Court below in the instant case contains the first suggestion to the contrary.

Consider the state of facts to which this doctrine is to be applied. In 1909, the appellant acquired practically all of the territory which it now holds. Relying upon the yield which so large an acreage promised, it proceeded from time to time to invest (as the District Court found) a total of some $26,000,000 in development of the gas and equipment for its marketing. Its customers, both foreign and domestic, made large individual expenditures in order to receive the gas it might be expected to supply. During the year preceding this suit, it sold 47,000,000,000 feet, and now holds in its "proven" as distinguished from its "probable" or "possible" territory 249,000,000,000 feet, or but a five years' supply. But for the remaining property, that would measure its years of life. Yet, because it is only from this pool that present drafts are being made, it may earn nothing on the residue that it holds, no matter how clearly its value may be proven, nor how sure it is that it must be resorted to in the future. The "probability" of the presence of 414,600,000,000 additional feet of gas under its control would be a potent element of value if its properties and plant were exposed to sale in the open market; it would have to be paid for if it were taken by eminent domain; but it means nothing when a rate base is to be arrived at in a valuation case!

Of course it is conceivable that a natural gas company might accumulate or acquire a reserve acreage so large in

comparison with that actually in use, so utterly unrelated to any present or prospective demand, that it might be treated as idle capital so invested as to have no genuine connection with that portion of the property in public use. Under such circumstances, it might be segregated from the remainder of the property in ascertaining the rate base. *Mutatis mutandis*, the same thing might occur in the case of any other public utility. We say this is conceivable, although in the case of a natural gas company it is in the highest degree improbable, but certainly there is nothing in the present record to lend countenance to such a claim.

On this subject, Mr. Sullivan, one of the vice-presidents and general manager of the Hope Natural Gas Company, Mr. Corrin, one of the vice-presidents of that Company, and Mr. Gregory, the president of the Manufacturers Light & Heat Company, among the largest gas producing companies in the United States, have explicitly testified that appellant has no more gas reserves or gas rights than are sufficient to justify the plant; that good business judgment would not only justify but require the acquisition of any further acreage that could be acquired, and, in substance, that it would be impossible to finance the construction of such a plant as appellant's with less acreage than it has. This testimony is not controverted by the statement or the opinion of any witness in the case. Even Hagenah, protestant's expert, admits that appellant's plant could not be built on the basis of a five years' supply; that it is a good thing for the public that appellant has an eighteen year supply, and would be better if it had a twenty-five year supply (R., 465). We must assume that if any one familiar with the natural gas business held a different opinion, he would have been called and his testimony put in the Record. It follows that if appellant had been limited to the 136,000 acres of natural gas rights the plant could never have been financed, never would have been built, and protestants would never have had the gas.

In *Southern Bell Telephone Co.* vs. *Railroad Commission of South Carolina*, 5 Fed. (2nd) 77, 94 5, it was held that

additional equipment provided for future years was not idle capital in any sense of the term and must be included in the rate base. Said the Court (p. 91):

> "A business concern, and especially a telephone company, must look to the future as well as the present. It is a part of wisdom to forecast the growth of communities they serve, and to be prepared to meet new conditions as they arise."

If this is true in regard to telephone equipment, the supply of which may be increased by manufacture at any given time, how much more applicable is the rule to a vanishing commodity such as natural gas, which exists in strictly limited quantities and is incapable of renewal or increase. After large sums have been spent in creating facilities for its distribution and sale, after consumers have adapted their mains and factories to its use, it would be mismanagement amounting to a breach of faith not to provide and maintain as an integral part of the property the most substantial territorial reserves.

The capital invested in such reserves cannot be withdrawn by the Company at pleasure to be devoted to other uses without decreeing the death of the entire enterprise; and having thus passed beyond the voluntary withdrawal of the Company, it is as utterly and irrevocably devoted to the public use as anything else that it owns. It is in no sense a speculative investment or a convenient depositary for surplus funds.

3. The District Court erred in holding, contrary to the undisputed evidence, that the value of appellant's tangible or physical property, including going concern value and working capital, was not more than $29,990,000.

The value placed by the District Court upon the so-called tangible or physical property of the appellant (which, as stated at page 14, *supra*, does not include its gas territory)

is an aggregate of $26,000,000 as the fair value of the inventory, $990,000 working capital, and $3,000,000 for going concern value, totalling $29,990,000. The allowance for working capital is agreed to on all hands, but the other items are in dispute. To these we address ourselves.

In cases of this character involving many items of property, there are quite often several valuations by different engineer experts, who disagree as to the value of the various items going to make up the whole property or as to the value of the same as a whole. In the instant case, however, while the property has been valued or appraised by engineer experts employed by both sides, it is notable that there is no disagreement as to the items of property making up the plant or as to their value new. Such disagreement as there is is only in regard to the theories upon which overhead charges, depreciation and going concern value are to be computed.

(a) *Fair value of the inventory.*

Appellant's witness, Uebelacker, of the firm of Ford, Bacon & Davis, with a corps of assistants, made a detailed inventory of the so-called physical property of the appellant. The general nature of this property has been described at page 14 hereof, *ante*, and need not be repeated here. The result of his labors was embodied in several large volumes, but in view of the fact that the expert employed by appellees conceded the correctness of his inventory and appraisal in every particular, only a summary thereof has been incorporated in the Record (Uebelacker Exhibit No. 1, R., 496-552). His testimony explanatory of and supplemental to this Exhibit begins at R., 195.

In performing this task, the witness examined every item of the Company's property and noted its present condition at the time, uncovering the pipe lines at such frequent intervals as would assure him of their size and present condition. He then applied to each item of property the present day price thereof, and by adding these together reached the

total sum which would be required to construct the plant new. To this sum he added what he considered the proper overhead charges, and thus reached the conclusion that the cost of constructing the physical plant new, less observed deterioration, would be $28,631,320, as follows (Table, R., 537-8):

Total Production System (new, less deterioration)	$46,577,095	
Less land, leaseholds and natural gas rights	36,449,176	
		10,127,919
Total Transmission system (new, less deterioration)		14,424,364
Total Distribution system (new, less deterioration)		3,349,509
Total General property (new, less deterioration)		729,528
		$28,631,320

After Mr. Uebelacker had completed his report and testified in support thereof, an adjournment was taken for the purpose of enabling protestants to verify or controvert his statements. They employed for the purpose W. J. Hagenah, whose experience in such work is detailed in his testimony beginning at page 424 of the Record. He and his corps of assistants spent several months in this work and found absolutely no matter of disagreement with Uebelacker, either as to a single item of property to be included in the inventory or as to the value to be attributed to any such item (R., 467, 486). Hagenah's points of difference with Uebelacker are entirely on matters of theory, viz., the allowance for overheads, allowance for depreciation and allowance for going concern value.

(b) *Allowance for overheads.*

Mr. Hagenah approves all of Mr. Uebelacker's allowances for general overheads with the exception of cost of financing, amounting to 4%, and that of interest during construction which, in the former's opinion, should be 7% instead of 8%, Uebelacker's rate (R., 475-6).

As to the cost of financing, Hagenah (R., 475), who is supported by protestant's accountant witness Jirgal (R., 407, 422), takes the position that this is nothing more than bond discount which, under what these witnesses state is a proper system of accounting, should be amortized over the life of the securities to which it appertains. But Mr. Uebelacker, both in his report (R., 519) and in his oral testimony (R., 197-8), makes it very clear that this item of 4% which he has included is not discount upon securities at all and "must not be confused" therewith. It is simply the "expense of assembling the necessary capital for the enterprise", including "the expense of distributing securities to the public". This is unquestionably an inevitable incident of financing any undertaking requiring any considerable amount of capital.

Re Utah Power & Light Co. (Utah), P. U. R. 1922 A, 436;
Re Utah Light & Traction Co. (Utah), P. U. R. 1920 B, 262.

As to the rate of interest during construction, Uebelacker testifies that his allowance of 8% is based upon his actual experience in the construction of a similar plant, while Hagenah's estimate that 7% is a sufficient allowance is admittedly merely an opinion (R., 476), he having in mind no specific instance of any plant that has been financed on that basis, and never having had any actual personal experience in the construction of a plant like appellant's (R., 475).

Thus we have a deduction based upon experience contrasted with a mere opinion not based upon any actual data. As this Court said in *Pacific Gas & Electric Company* vs. *San Francisco*, 265 U. S., 403, 406:

> "Facts shown by reliable evidence were preferable to averages based upon assumed probabilities."

(c) *Allowance for depreciation.*

As noted above, Mr. Uebelacker's computation of the reproduction cost new of appellant's physical properties, less deterioration and exclusive of going concern value, is $28,631,320. Appellees' witness Hagenah values this property upon the same basis at $23,969,180 (Table, R., 1166-8, his total of $30,702,100 including the book cost of the gas land, leasehold and rights, $6,732,920). A part of this difference, amounting to $1,662,140, is accounted for by the difference in theory between these witnesses upon the question of overheads, heretofore discussed. The remainder results from the different theories of computing depreciation adopted by them respectively.

Uebelacker, as we have shown, in determining the present value of the physical property *observed it in its actual condition*, and valued it upon that basis. Hagenah expressly admits that Uebelacker's conclusion is right if his theory is sound (R., 486) and that he would have come to the same conclusion if he had adopted the same theory throughout. He contends, however, that this method is not applicable in instances where the life of the property depends on the life of the field, and that in those instances depreciation should be computed on the "straight line" basis—that is, at a certain uniform percentage each year during the life of the property (R., 426-7).

That Mr. Uebelacker's method of computing depreciation is the correct one would appear to be settled by the decision of this Court in *Pacific Gas and Electric Company* v. *City and County of San Francisco*, 265 U. S. 403, where the same

question was involved and what was termed the "modified sinking fund method" was used to determine accrued depreciation. Respecting this, the Court said (p. 406):

> "Appellant objects to the application of this method and insists that depreciation should have been ascertained upon full consideration of the definite testimony given by competent experts who examined the structural units, spoke concerning observed conditions and made estimates therefrom. As these examinations were made subsequent to the alleged depreciation for the definite purpose of ascertaining existing facts, we think the criticism is not without merit. *Facts shown by reliable evidence were preferable to averages based upon assumed probabilities.* When a plant has been conducted with unusual skill the owner may justly claim the consequent benefits. The problem was to ascertain the probable result of the specified rate if applied under well known conditions, not to forecast the probable outcome of a proposed rate under unknown future conditions." (Italics appellant's.)

This case, among others, was cited and followed in *McCardle v. Indianapolis Water Co.*, 272 U. S. 400, 416, where the straight line method of computing depreciation "based on age and the estimated or assumed life of perishable elements", was expressly condemned, the Court saying:

> "The testimony of competent valuation engineers who examined the property and made estimates in respect of its condition is to be preferred to mere calculations based on averages and probabilities."

The Public Service Commission of West Virginia were of the opinion that Mr. Uebelacker's conclusions must be adopted. Commissioner Stathers says on this point (R., 127):

> "Having used the observed depreciation method in arriving at the present condition of the property, we see no reason for departing from such method and ac-

> cepting the theoretical, speculative and arbitrary assumptions and calculations concerning the future needs of this company for depreciation purposes,"

citing *Pacific Gas and Electric Company* v. *City of San Francisco, supra.*

Mr. Uebelacker's method is, nevertheless, questioned by the Court below. It contented itself, however, with pointing out that the Commission approved the procedure of Mr. Uebelacker resulting in a figure for reproduction new, less observed depreciation, of $28,366,988. This, says the Court, (R., 1246) the Commission would no doubt have adopted had it not had before it other testimony as to "investment, cost and many other more or less relevant matters to which they felt in duty bound to give consideration". And since one of the majority members of the Commission concluded that the fair present value of the tangible property was $25,000,000, and his colleague $26,000,000, the latter is adopted by the Court without more saying as the outside figure. Neither the Commission nor the Court furnish any figures or expose the mental process by which their conclusions are reached. Both Chairman Stathers (R., 95) and Commissioner Divine (R., 1356) say in substance that they gave consideration to all the different valuations which were before them. If they took into consideration Mr. Hagenah's valuation they relied upon a conclusion which is condemned by the passage from Chairman Stathers' opinion quoted above. Just what weight was given by either Commissioner to the various valuations reached upon conflicting theories does not appear but, as we have pointed out (*supra*, p. 43), Uebelacker and Hagenah agree that upon the former's theory of "observed depreciation" the present fair value of the property is $28,631,320.

Cost of Dry Wells.

It should be mentioned that in Uebelacker's inventory and appraisal of appellant's physical property there is included

an item of $254,332, the cost to appellant of drilling "dry" or unproductive wells. Mr. Stathers (R., 89), although he admits that the claim might be made that some value should be given to such "dry wells" because of the fact that they have had a certain use in helping to delimit the productive area, expresses the opinion that such value should be and is included and considered as one of the elements of going concern value, and therefore declines to consider this item as entering into the present fair value of appellant's physical property. He inquires whether a public utility furnishing water could include a "dry well" in determining the present fair value of such utility, or could so include the cost of an abandoned reservoir. While the answer to the latter question may well be in the negative, it is contended that the former, like appellant's case, presents a different situation. The purpose of appellant's being is the discovery and supply of natural gas. The boundaries of the pool and the direction in which it extends can only be determined by the drilling of a number of wells which, together, indicate the location of the pool and enable the drilling of such additional wells as may be necessary at a minimum risk of failure. The cost of the experimental wells which turn out to be unproductive therefore enters into the expense of locating the gas just as much as that of the productive ones which actually supply it, and it is therefore submitted that this item should not have been disallowed.

The Court (R., 1245) below disposed of this item by the statement that it was unable to make certain whether any part of it was included in Mr. Uelselacker's allowance for depreciation, and the further statement that the item is so small as to be unessential. This item is nearly a thousand times as large as that which this Court, in *Ohio Utilities Company* vs. *Public Utilities Commission of Ohio*, 267 U. S. 359, 363, took into consideration, commenting upon the fact that there was no explanation in the Record of its disallowance.

If, however, the Court is of the opinion that the cost of the unsuccessful wells does not properly enter into that of appellant's production plant which has resulted in the supply of natural gas which the protestants and others are now enjoying, Mr. Uebelacker's valuation discussed above will necessarily be reduced by the amount of this item, $254,332.

(d) *Going concern value.*

It is admitted by all parties and abundantly established by the decisions of this Court that there is an element of value inhering in this and all similar properties variously termed "going value" and "going concern value."

> *City of Knoxville* vs. *Knoxville Water Company*, 212 U. S., 1;
> *Des Moines Gas Company* vs. *Des Moines*, 238 U. S., 153, 165;
> *McCardle* vs. *Indianapolis Water Company*, 272 U. S., 400.

This element is "an expression of the added value of the plant as a whole over the sum of the values of its component parts" (*City of Knoxville* v. *Knoxville Water Co.*, 212 U. S. 1, 9), is a property right upon which the owner is entitled to a fair return, and must be considered in valuing the property for rate making purposes.

One of the points of difference between the experts, however, is as to the value which should be assigned this element in the instant case. The appellees' witness Hagenah (R., 428-9) expresses the opinion, for reasons stated by him, that 10%, in this case $3,000,000, is a proper allowance for going concern value. Appellant's witness Uebelacker (R., 208-9) estimates the going concern value of the appellant's property at from $3,000,000 to $3,500,000 at the lowest, and instances many facts which he thinks would justify a larger value, but states that there is no formula for estimating it

in dollars and cents. At a later stage of his testimony, however, (R., 224) he estimates the going concern value at the difference between reproduction cost new and reproduction cost new less deterioration, or $8,423,105 (table, p. 15, *supra*). He explains this by the statement that while the plant is not new and deterioration would have to be allowed for in valuing it as a dead plant, it was, according to his observation, functioning as efficiently as a new plant or its equivalent would do, and for this reason was worth as a functioning plant 100% of the reproduction cost new.

We commend this view to the Court as entirely reasonable. This Court has recently, in *McCardle* vs. *Indianapolis Water Company*, 272 U. S. 400, p. 415, expressed the opinion that under the decisions which it cites, 10% of the value of the physical elements would be *low* as an allowance for going value when the "impressive facts" reported in that case were taken into account. It is confidently submitted that the facts disclosed by the record in this case are at least equally impressive in this connection. If, however, the Court inclines to the opinion that Hagenah's estimate of 10% rests upon a sounder basis, that rate will necessarily have to be applied to the increased rate base if the Court sustains appellant's contentions hereinbefore discussed as to the overhead and other items.

For convenience we append a table showing by way of summary the differences in the valuations of the witnesses Uebelacker and Hagenah:

Physical Property	*Uebelacker (R. 536-8*	*Hagenah R. 1166-8*	*Difference*
1. Reproduction new without overheads	$29,991,114	$29,992,502	1,388
2. Overheads	7,063,311	5,398,650	1,664,661
3. Value new	37,054,425	35,391,152	1,663,273
4. Value depreciated (including reduced overheads)	28,631,320	23,969,180	4,662,140
5. Going concern value	8,423,105	3,000,000	5,423,105
6. Present fair value, physical property and going concern value	37,054,425	26,969,180	10,085,245
7. Gas properties	36,449,176	6,732,920	29,716,256
8. Working capital	990,000	990,000	
Total of last three items, 6, 7 and 8	$74,493,601	$34,692,100	$39,801,501

4. *The District Court erred in not including in the value of appellant's tangible or physical property the sum of $2,044,778.24, being new investment in physical property added and actually put in use in the public service during the year 1924, according to the undisputed evidence.*

It will be noted that the Public Service Commission declined to include as an item of value the larger part of these additions to the plant during the year 1924 for the reason that as it held, it was not specifically shown that they were being used in the public service (R., 95-6). Upon the hearing of the case in the Court below, however, it was clearly proven

that all of these items of property had been placed in use during the year 1924 (R., 335-6.) The testimony of the witness Hightower is explicit. This proof was evidently entirely overlooked by the Court. The item should be added to the total of $74,493,601 above given.

II.

The District Court erred in holding, contrary to the undisputed evidence, that the value of appellant's property devoted to the public service in West Virginia was not more than $11,251,499.

If this Court agrees with appellant's contentions discussed in the preceding Point I as to the proper rate base, it is manifest that the same facts and principles are equally applicable in determining what proportion of appellant's property is used and useful in the public service in West Virginia. The computation of the West Virginia rate base is merely a matter of applying the proper percentages to the value of the entire property; and if an erroneous result has been reached in determining the latter, the error necessarily is carried into the former. Appellant's contentions in this respect, based upon the testimony of its witness Uebelacker (R., 213, *et seq.*), and the tables in his Exhibit 5 (summarized at R., 593), result in a total of $17,702,672 on the basis of reproduction cost new and one of $16,477,205 reproduction cost new less deterioration. The latter does not include anything for going concern value; nor does it include the allocable proportion of the $2,044,778.24 worth of new property referred to in subdivision 4 of the preceding Point (*supra*, p. 49). Upon this witness's theory that going concern value in the case of this Company is equivalent to the difference between reproduction cost new and the same less deterioration, such going concern value is of course included in the total of $17,702,672.

Appellee's witness Jirgal, in his table (R., 1067) and testimony explanatory thereof (R., 381, *et seq.*) computes the West Virginia rate base at $8,278,267. This calculation is, however, based entirely on the book cost of the property (R., 381), which method it is believed has been demonstrated to be absolutely erroneous. His estimate may therefore be disregarded.

The Court below (R., 1272-3) computed the "value of property used in regulated business" as follows:

Tangible property	$7,530,826.
Going Concern value	847,350.
Working capital	282,546.
Gas reserves	2,590,677.
Total	$11,251,399.*

In making this computation the Court states that "the parties have agreed as to percentages of the value of various portions of its property properly allocated to its public service activities." While the exact percentages are not stated in the opinion, it appears from the Court's calculation it attributed 28.96% of the tangible property to the regulated service and 25.13% of the assumed value of the gas reserves. Appellant is willing to concede that these percentages are substantially correct, although as a matter of fact there are slight differences between the experts in this respect. The application of such or similar percentages to the total rate base will therefore result in ready ascertainment of the proportion thereof applicable to the public service in West Virginia.

Appellant's contention as to the value of the property devoted to the public service in West Virginia upon which it is entitled to a return appears under Point VI *infra* and is for brevity's sake omitted here.

*The Court seems to have made a slight error of $100 in addition (R., 1272), making this total $11,251,499.

III.

The District Court erred in holding, contrary to the undisputed evidence, that 3.65% per year of the value of appellant's property was a proper allowance for amortization.

There is a radical difference between a company engaged in producing, selling and distributing natural gas and one whose business is supplying artificial gas, electricity or water. The commodity supplied by the latter may for practical purposes be considered as inexhaustible. The former resembles a mining or an oil company in that the product which it purveys, when once consumed, cannot be renewed and is gone forever.

It necessarily follows that such portion of the physical plant of a natural gas company as cannot be commercially used for other purposes when the supply of gas is exhausted then becomes worthless apart from such salvage value as the material composing it may have.

In order, therefore, that the investor may recover the value of his property the price of the gas to the consumer must include: (1) the value of the gas as it is supplied and consumed, and (2) a proper allowance for amortization of the physical property used in supplying it while it is available, but which will become useless when it gives out.

It is thought that it has been shown that the thing to be thus amortized is the fair value of the property at the time of the inquiry—not its original cost, whether that be greater or less. In other words, it is the rate base which is the subject of the amortization.

Minnesota Rate Cases, 230 U. S. 352, 454;
Willcox v. *Consolidated Gas Company*, 212 U. S. 19;
Missouri, ex rel, Southwestern Bell Tel. Co. v. *Public Service Commission*, 262 U. S. 276;

Bluefield, etc. Company v. *Public Service Commission*, 262 U. S. 679, 690;

McCardle v. *Indianapolis Water Company*, 272 U. S. 400;

Michigan Public Utilities Commission v. *Michigan State Tel. Co.*, 228 Mich. 658; 200 N. W. 749-752.

While some of the authorities cited lay down the rule in regard to depreciation their doctrine is as clearly applicable to amortization, if not more so.

Chairman Stathers of the West Virginia Public Service Commission accepts this view (R., 123-4). He falls into the error, however, of deducting from the rate base which he reaches of $35,999,969.14, in addition to the working capital of $990,000 the further sum of $14,028,737.03 which he says is the amount of property already amortized as of December 31, 1923. He overlooks the fact that the last mentioned sum has already been deducted by Uebelacker in arriving at his valuation of the property which the Chairman says he has considered (R., 95), the result being a double deduction for the purpose of his calculation of the sum to be amortized. The effect of this is to deprive the appellant of any compensation whatever for the gas already sold and delivered to its customers and the depreciation which its plant has already suffered.

Chairman Stathers assumes a life for the property of eighteen years from December 31, 1923, and finds 4.15% as the rate sufficient and necessary for the amortization of the unamortized portion of the present fair value thereof.

Commissioner Divine disagrees with Chairman Stathers as to present fair value being the proper basis of amortization and holds that only the actual investment can be amortized.

But even if Chairman Stathers were correct, and appellant had collected in the past more than it should have done, its present position would not be affected thereby. This Court has repeatedly held that the fact that a public utility

has collected excessive rates in the past cannot be considered in determining its rates for the future.

> *Board of Public Utility Commission* v. *New York Tel. Co.*, 271 U. S. 23, 31, 32, and authorities there cited.

Appellees' witnesses, Hagenah (R., 448) and Jirgal (R., 410-1) have rejected the present fair value basis and based their computations for purposes of amortization solely on actual book cost. The error of this theory has been pointed out.

The Court below evolved a different conclusion. As we have shown, it disagreed with the Commission in its view that all appellant's gas reserves were used and useful in the public service and held that only a five years' supply, or two hundred and forty nine billion cubic feet, was to be considered as entering into the rate base (R., 1263-4). In discussing the subject of amortization, however, it proceeds on the assumption that eighteen years is the probable term of appellant's activity in the natural gas business (R., 1235-6). It must, therefore, for this purpose assume that the appellant has a supply of gas to last this period, thus introducing as a factor Mr. Davis' estimate of six hundred and sixty three billion cubic feet. The inconsistency is apparent. If appellant had only a five years' supply of gas available, this gas and the plant would necessarily have to be paid for and amortized in that length of time. If, on the contrary, it has eighteen years' supply which it is entitled to amortize over that period, it is difficult to see why it is not entitled to a return upon the money spent in securing and holding it. Upon the Court's theory it would ultimately receive payment for only 5/18ths of the gas which it is assumed it will deliver to its customers over the period of eighteen years.

Further, assuming that eighteen years is as fair a prophecy as can be made of the term of appellant's natural gas

business, no sufficient reason appears for the Court's reduction of the rate of amortization from 4.15% as determined by Chairman Stathers to 3.65%. The Court calculates that a little less than 3.9% computed annually at 4% for eighteen years will produce the necessary sum. It cites no precedent where this theory has been adopted, nor has appellant been able to find any.

It is not even yet content and goes on to reduce this 3.9% to 3.65% upon its expressed conviction that the latter will be a "generous allowance" for amortization (R., 1236). The only reason stated for this last paring is that: "It is highly probable the plaintiff can so use funds of its amortization reserve so as to get more than 4% per annum for them. *Savings Banks will pay it as much*" (Italics ours).

As indicated above, Chairman Stathers (R., 124) computes the sum to be amortized as $20,981,232.11, 3.65% of which is $765,814.97. If we assume $5,000 as the limit which any savings bank will take from any one depositor the practical value of the suggestion italicised becomes apparent.

IV.

It was error to add to the earnings of the appellant, as reflected by its books, the sum of $1,495,496.69 as additional compensation which it was held should have been charged to certain customers of the appellant for gas sold them in excess of the price actually charged and received.

It appears (R., 379, Jirgal Exhibit 1, R. 1065,) that appellant had contracts with Columbia Gas & Electric Company and Ohio Fuel Supply Company under which it sold them in 1923 17,613,173,000 cubic feet of gas at the average rate of 7.25 cents per thousand cubic feet, a total of $1,282,100.69. The two companies mentioned own all of appellant's capital stock. Appellee's witness Jirgal calculated that a fair rate

tor this gas would have been 15.77 cents per thousand cubic feet, or $2,777,597.38, and "adjusted" appellant's earnings accordingly by surcharging them with the difference of $1,495,496.69. In this he was sustained by the majority of the Commission (R., 132,139). In reference to this item, the Court says (R., 1238):

> "In determining what return plaintiff made to those interested in it, we do not understand that it questions that there should be added to its earnings as they appear upon its books, the difference between the price paid to its stockholders and what it could have gotten from others for the gas they took."

Appellant more than questions the propriety of this "adjustment"—it denies it.

Appellant is entitled to a fair return upon its property *used and useful in the public service in West Virginia*, irrespective of its profits or losses in its other business:

> *Smyth* vs. *Ames*, 169 U. S., 466, 541;
> *Northern Pacific Ry. Co.* vs. *No. Dak.*, 236 U. S. 585;
> *Norfolk & Western Ry. Co.* vs. *W. Va.*, id., 605;
> *Vandalia Railroad Co.* vs. *Schnull*, 255 U. S., 113;
> *Atchison, Topeka & Santa Fe Ry. Co.* vs. *State*, 47 Okl., 237; 148 Pac., 144, 148.

The question of what is a fair return upon that portion of its property is the only one of which the Public Service Commission of West Virginia has jurisdiction.

In *Chas. Wolff Packing Co.* vs. *Court of Industrial Relations*, 262 U. S., 522, this Court said, through the Chief Justice (p. 539):

> "To say that a business is clothed with a public interest is not to import that the public may take over its entire management and run it at the expense of the owner."

Appellant charges that this is precisely what protestants have persuaded the Public Service Commission of West Vir-

ginia to attempt to do in the case at bar with appellant's business. That body has injected into the question of a fair return upon appellant's property used and useful in the public service, which alone it is empowered to regulate, an element relating solely to the business management of other property not so used and wholly unconnected therewith.

> "Broad as is its power to regulate, the State does not enjoy the freedom of an owner. Appellee's property is held in private ownership; and, subject to reasonable regulation in the public interest, the management and right to control the business property of the company belong to its owners."
>
> *Banton* vs. *Belt Line Railway Corp.*, 268 U. S., 413, 421.

There is no intimation in the Record that the supply of gas furnished to the protestants and other domestic and industrial consumers in West Virginia is not adequate and that the service is not efficient. The contrary appears. Appellant is compelled to and does take care of its domestic consumers first, although at the season's peak demand this requires the curtailment of its industrial consumers, which is the more profitable branch of its business (R., 340, 347). It is submitted that as long as it meets the requirements of its public service consumers, it is no one's business but its own what it does with its surplus output. It therefore respectfully insists that the so-called adjustment of its revenues by the addition of $1,495,496.69, supposed to represent the difference between what it might theoretically charge its parent companies for gas not required for the public service, and what it does actually charge them, for reasons with which the Public Service Commission is not concerned, is clearly erroneous.

> *State of Missouri ex rel. Southwestern Bell Telephone Co.* vs. *Public Service Commission*, 262 U. S., 276, 289, citing and quoting from *State Public Utilities Commission* vs. *Springfield Gas & Electric Co.*, 291 Ill., 209, 234.

V.

The District Court erred in charging appellant's earnings with the sum of $934,393.41 as presumptive profit on the extraction of gasoline from the natural gas marketed by appellant, instead of the true amount earned by appellant from such gasoline extraction, as reflected by its books.

It appears that natural gas when discharged from the well contains a certain amount of gasoline which is marketable. It further appears that by the extraction of this gasoline the gas is made more suitable for transmission in that there are eliminated from it those liquid particles which might be left in the transmission lines with the double effect of retarding the transmission, and attacking the rubber in the joints (R., 220).

Virginia Gasoline & Oil Company is a corporation, all of the stock of which is and was at the date of the judgment under review held by the same parent companies which then held the stock of appellant and in the same proportions. Appellant has a contract with said Virginia Gasoline & Oil Company to extract the gasoline from the natural gas which it produces (R., 130, 225), by the terms of which appellant receives a royalty of one-eighth of all gasoline produced. This royalty has been regularly paid and accounted for in the statement introduced by the appellant. Appellees' witness Jirgal was of the opinion, however, that this did not give to the Gas Company a sufficient return for the gasoline extraction privilege, and accordingly made a further "adjustment" of appellant's earnings by including therein one-half of the net earnings of the gasoline for 1923, $934,393.41 (R., 1158), the proportion of which he allocated to the West Virginia Public Service being $234,626 (R., 1162). Realizing that this addition to its income would subject

appellant to increased income taxes, he made a calculation thereof resulting in the allocation to the West Virginia regulated property of $37,836. of such tax (R., 1162). This adjustment was sustained by the Commission on the theory that the parties to the contract in question are so closely allied that the royalty reserved cannot be taken as a true measure of value (R., 131, 139) and the Court below agrees with this position upon the authority of *City of Charleston* vs. *Public Service Commission*, 95 W. Va., 91. Appellant contends that this conclusion is erroneous. It rests upon the mere assumption that the consideration fixed by the contract for the gasoline extraction privilege is unfair to the public because the stockholders of the contracting parties are the same. It is submitted that there is no ground for any such assumption; that the presumption is the other way, and the burden of proof is upon those who attack the obligation of the contract.

> *State of Missouri, ex rel, Southwestern Bell Telephone Company* vs. *Public Service Commission*, 262 U. S. 276.
>
> "Every investment may be assumed to have been made in the exercise of reasonable judgment, unless the contrary is shown."

Per Mr. Justice Brandeis, id., page 289, footnote.

See also

> *Interstate Commerce Commission* v. *Chicago Great Western Ry. Co.*, 209 U. S. 108, 119.

The only evidence in the Record that in any way might suggest that this contract is anything but fair is that of the witness Krebs (R., 486, *et seq.*). The evidence shows that his experience has not been large. He testified at length to the terms of one contract made upon the basis approved by the Commission in the instant case, but it further appeared that the party who undertook to pay a one-half roy-

alty became insolvent and was unable to carry it out (R., 489-90).

But even if it be considered that one-half of the net profits derived from the gasoline business is a fair consideration for the privilege of extracting the gasoline, it is submitted that it was not proper to take the net earnings of 1923 as typical.

It appears that this year 1923 was an exceptional one. The gasoline earnings for the year 1924 are shown by months in Hightower Exhibit Z, (inserted between pages 1002 and 1003 of Record) and the total for that year in Jirgal Exhibit No. 9a (Rec., p. 1160). It will be noticed from this latter exhibit that for the year ended December 31, 1924, the net gasoline earnings were $1,066,110.32 as compared with $1,868,786.82 for the year 1923 (Rec., p. 1066). This very substantial decrease in the earnings from gasoline is accounted for by the fact that during the early part of the year 1924, a new process known as the "cracking process" was put in common use for the extraction of gasoline from crude petroleum which resulted in obtaining more than twice the quantity of gasoline that was formerly obtained from the same quantity of oil; and, inasmuch as the quantity of gasoline produced from natural gas is less than 10% of the total production of gasoline in the United States, the remainder being made from crude petroleum, the price was necessarily controlled by the cost of producing from crude petroleum (Rec., 413, *et seq*).

Mr. Hagenah expressed the opinion that the price of gasoline was only temporarily depressed. The chart introduced by Mr. Hightower (insert between pages 986 and 987 of Record) shows the falling trend of gasoline prices since the year 1920. It appears from this chart that the price received by the producer for gasoline fell from 25.73 cents in 1920 to 11.45 cents in the latter part of 1924.

Gasoline is an article of such universal use and the price so generally known that the Court no doubt will take judicial notice of the fact that Mr. Hagenah's prophecy has not up to this time been fulfilled.

VI.

The rates complained of in the bill are insufficient to produce a fair return on the value of appellant's property, and are therefore confiscatory.

If appellant is correct in its principal contention; viz, as to the value of its gas properties and that the whole of such value must be included in computing any rate base, a simple though somewhat rough calculation will show that even if every other point of difference be conceded, the existing rates are confiscatory by a wide margin.

We illustrate this by assuming a rate base, a net income from the property devoted to the public service in West Virginia, and a rate of return, on the theory that every matter in controversy, except as to the gas properties, is decided against appellant.

Hypothetical Rate Base.

Physical property, new less depreciation, including overheads (Hagenah's figures, Table, p. 43, *supra*, items 4 and 5	$23,969,180
Going concern value	3,000,000
Working Capital	990,000
Addition in 1924	2,044,778
Gas properties (lowest valuation by any of appellant's witnesses	30,000,000
Total	$60,003,958

West Virginia rate base.

Appellant's witness Uebelacker (R., 593) found the reproduction value new, less deterioration, of the property which he allocated to the West Virginia Public Service, to be $16,477,205, which is 24.9% of the value of all the property so found by him to be $66,070,496 (R., 536). This includes allocation of working capital, but not going concern value.....

Appellees' witness Jirgal's corresponding figures in his table at page 1067 of the record work out a similar ratio of 27.34%.....

Uebelacker's ratio of .249 has therefore been used for this demonstration as being smaller and less favorable to appellant. Being applied to the several items of the hypothetical rate base above, it gives the following result:

Physical Property	$5,968,326
Going Concern Value	747,000
Working Capital	246,510
Additions in 1924	509,150
Gas properties	7,470,000
Total	$14,940,986

which is accordingly assumed as the value of appellant's property used and useful in the public service in West Virginia .....

Net Earnings on West Virginia Rate Base as Above.

Uebelacker found these to be (R., 591, gross $2,155,475, less expense $946,038)		$1,209,437
Jirgal computed them, after his various "adjustments", at R., 1067		1,567,373
The Court below, at	$1,555,593	
or, after deducting what it says is "the proper proportion of the total sum allowed for annual depreciation" (R., 1272)	113,658.	
		1,441,935

Rate of Return.

	Per cent.
Chairman Stathers allowed:	
For annual depreciation (R., 128, 132)	1.12
For amortization (R., 125, 132)	4.15
For return (R., 130, 132)	8.00
	13.27

The Court held (R., 1236) that a "generous" allowance for amortization was	3.65
It seems to acquiesce in a return of	8.00
It also, apparently, adopts by reference the allowance for annual depreciation adopted by the Commission (R., 128, 1236)	1.12

Which rates are applied as follows:

Depreciation @ 1.12% on $6,477,476 (Physical Property)	$72,548
Return @ 8.00% on $14,940,986 (Total)	1,195,279
Amortization @ 3.65% on $14,694,476 (Total excluding working capital)	536,348
Total minimum sum which appellant must earn	$1,804,175

The application of these minimum rates for return, amortization and depreciation to the divisions of our minimum hypothetical rate base of $14,940,985 gives $1,804,175 as the minimum sum which appellant must earn upon its property used and useful in the public service in West Virginia if the confiscation of its property is to be avoided. This is over 15.12% more than the largest estimate made by any one of its net earnings from its so called regulated property for the year under scrutiny.

Indeed even a further concession might be made for the purpose of calculation and the point be conceded that the whole value of the gas reserves need not be included in the rate base but only, as held by the court, the part thereof which is sufficient for a five years supply; still it would be apparent that the present rates are confiscatory inasmuch as it appears on the face of the court's opinion that the court miscalculated the correct amortization rate. As above stated (*supra*, p. 55), the court sought an amortization rate which compounded at 4% annually would provide for the complete amortization in 18 years and found the same to be 3.9% (paring this down later to 3.65% for reasons not explained although for the present purpose the difference is immaterial). However, at the same time the court al-

lowed only so much of the gas reserve to go into the rate base as would be exhausted in five years. These two positions are clearly inconsistent. As pointed out at page 54 of this brief, it is only fair that if the Company is to be limited in its rate base to a five year supply, it must be allowed an amortization rate which will amortize that in five years. It cannot be limited to a five year supply rate base and to an eighteen year amortization rate. If, therefore, for purposes of argument, five years supply is used for a rate base, the figure which would be required to effect amortization in five years compounded annually at 4% would be (according to standard bond tables) 18.46% (that is to say, the figure for the five year period corresponding to the 3.9% figure of the court for the eighteen year period). And if this percentage is applied to the value of the Company's property devoted to public service in West Virginia on the basis fixed by the court (i. e., valuing the gas properties at $10,317,311, the five years supply, instead of $30,000,000, the eighteen years supply, as in the above table), we arrive at an equally clear demonstration of confiscatory rates, viz:

Hypothetical Rate Base

Physical Property (as above)	$23,969,180
Going Concern Value " "	3,000,000
Working Capital " "	990,000
Additions in 1924 " "	2,044,778
Gas Properties (5 year basis)	10,317,311
Total	$40,321,269

West Virginia Rate Base
(Using ratio as above of 24.9%)

Physical Property	$5,968,326
Going Concern Value	747,000
Working Capital	246,510
Additions in 1924	509,150
Gas Properties (5 year basis)	2,569,010
Total	$10,039,996

Net Earnings on West Virginia Rate Base

As above	$1,441,935

Rate of Return

Amortization (as corrected)	18.46%
Return (as above)	8.00%
Depreciation (as above)	1.12%
Depreciation @ 1.12% on $6,477,476 (Physical Property)	$72,548
Return @ 8.00% on $10,039,996 (Total)	803,200
Amortization @ 18.46% on $9,793,486 (Total excluding working capital)	1,807,878
Total minimum sum which appellant must earn	$2,683,626

Applying these minimum rates to the above divisions of the minimum hypothetical rate base of $10,039,995 gives $2,683,626 as the minimum sum which the appellant must earn upon its property used and useful in the public service in West Virginia if confiscation of its property is to be avoided. This would show the confiscatory character of the present rates even more strongly than the calculation given first above. The sum is so much more than the largest estimate made by any one of the net earnings from the so called regulated property for the year under scrutiny that it becomes immaterial whether an adjustment of the above amortization rate of 18.46% corresponding to the downward adjustment made by the court from its rate of 3.9% or to 3.65% is made or not. There can be no doubt that if the Company were limited to including in its rate base only a five year supply, an amortization rate corresponding to that basis will prove the present rates as confiscatory as they are on the basis of including in the rate base the whole eighteen year supply for which this brief is contending.

As stated, appellant has conceded for purposes of the foregoing calculations all of the points in controversy (except those relating to its gas properties) which it discusses in

this brief, including overheads, method of computing depreciation, going concern value, amortization allowance and Mr. Jirgal's "adjustments". It, of course, insists on these points and each of them, nor does it concede that 8% is a fair rate of return upon its investment in view of the hazardous nature of the business and the exceptional value of the article which it purveys and of the service which it provides; but inasmuch as the province of courts is not to make rates, but merely to determine whether a particular rate established by legislative authority is or is not violative of the constitutional guarantees, it can serve no purpose to enter upon a discussion of this phase of the situation. It is respectfully submitted that appellant has by an overwhelming preponderance of evidence shown that the existing rates are confiscatory, and that the courts below erred in holding that they were compensatory.

VII.

The order or judgment of the District Court should be reversed and this cause remanded with appropriate directions.

Respectfully submitted,

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IN THE

Supreme Court of the United States,

OCTOBER TERM, 1927.

No. [redacted] 4

UNITED FUEL GAS COMPANY,
Appellant,

vs.

THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA, BIRK S. STATHERS, ERNEST D. LEWIS, *et al.*

REPLY BRIEF FOR APPELLANT.

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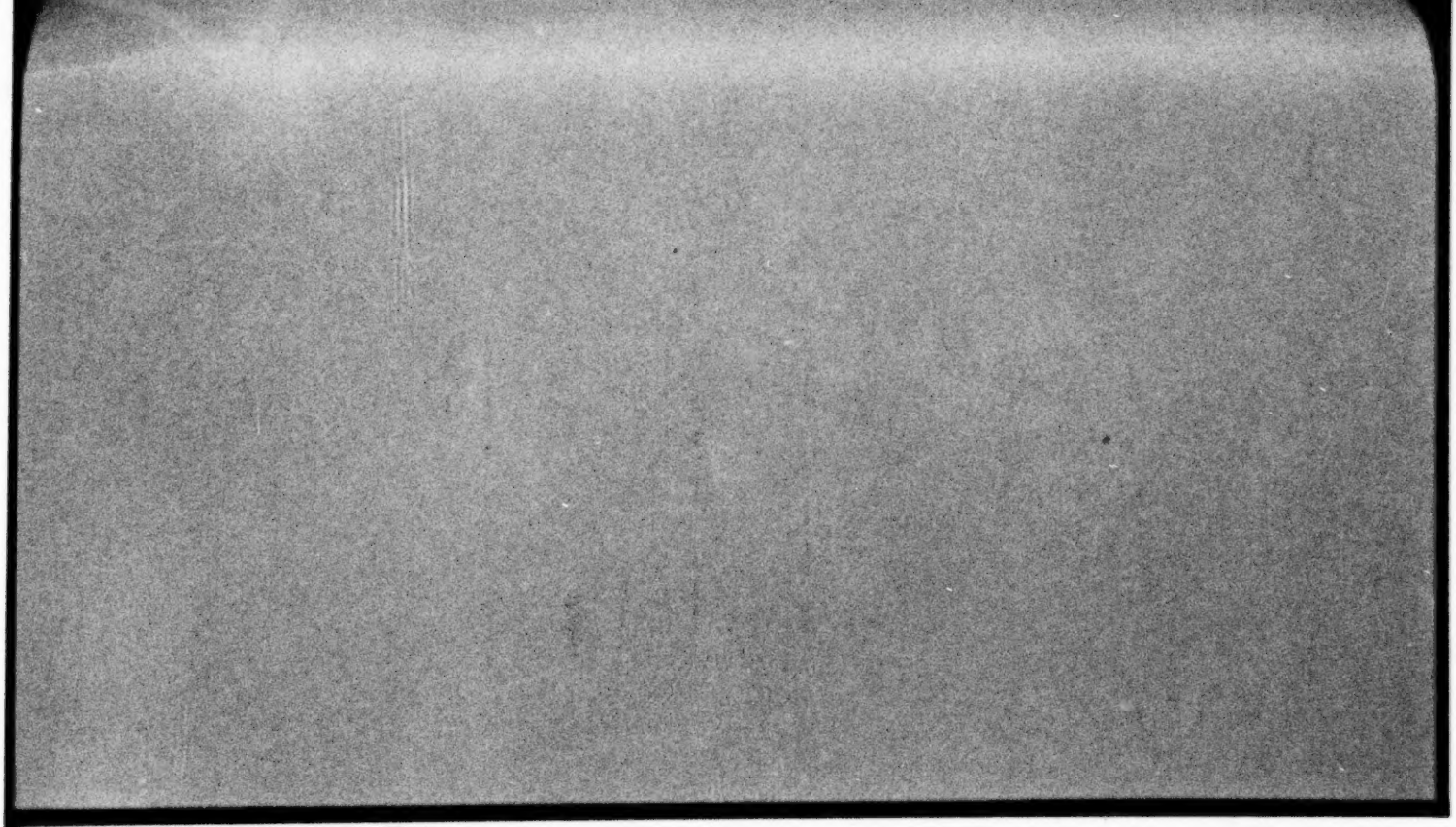

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1927.

UNITED FUEL GAS COMPANY, Appellant, vs. THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA, BIRK S. STATHERS, ERNEST D. LEWIS, *et al.*	No. 79.

REPLY BRIEF FOR APPELLANT.

The outstanding feature of the briefs filed on behalf of the Public Service Commission of West Virginia and the intervening appellees is a reversal of the accepted method of approach to a discussion of rates alleged to be confiscatory. As we understand the accepted practice, it consists in ascertaining, first, the rate base, second, the proper rate of return, and third, the determination of confiscation *vel non* by a comparison between the actual earnings and the earnings which would arise on applying the proper rate to the true rate base. The appellees, however, prefer to consider, first, the actual earnings plus what they are pleased to call certain readjustments; and having thus reached a putative revenue, they capitalize this sum at 8% in order to determine the maximum rate base. Having thus produced a capitalized figure in excess of any amount claimed on behalf of the appellants, they assert that the question of confiscation is thereby finally laid to rest, with the result that the crucial questions in relation to the true value of the appellant's property are reduced to a subordinate, indeed to a wholly irrelevant, posi-

tion. It is clear that this conclusion is solely dependent upon the amount of earnings the appellees are permitted to assume. Just how the appellees reconcile this method of reasoning with their vigorous insistence that the value of a rate base in rate making cases cannot be determined by its regulated return or earning power in the public service field is not made to appear.

Meeting the appellees, however, on their own ground, it is the purpose of this reply brief to point out various unwarranted adjustments and computations made by the appellees in reference to alleged earnings and certain fallacies of their discussion in regard to the value of the appellant's gas lands.

I.

Earnings.

(a) *Appellees have erroneously calculated amortization and depreciation on cost, whereas it should be computed on fair value.*

An amortization fund is for the purpose of returning to the stockholders of the Company the value of their property when it is consumed in the public service. A large part of the value of appellant's property is made up of gas in the ground. The remainder consists of the plant constructed for the purpose of producing this gas and transporting it to the consumer. If, because of enhanced values of the various properties going to make up the plant used for producing the gas and transporting it, it is worth more now than it was when it was constructed, we can conceive of no reason why it should not be paid for at its value at the time the payments are made. While it is the same property, it is true, still, as the witnesses have stated, the difference in value is not because of the difference in the property, but the difference in the purchasing power of the dollar. If the purchas-

ing power of the dollar has decreased as compared with the time at which the plant was constructed, and the value of the plant measured in dollars has correspondingly advanced, then when the stockholders are paid the money from time to time to take the place of the plant or to compensate them for the consumption of the plant in performing its work, they should be paid a sufficient amount over what the plant cost when it was installed to make the money which they get of the same value as the money they put into the plant. This same thing is true as to the gas that is used, but in much larger measure. The gas territory was acquired when the possibilities were unknown, and, of course, after millions of dollars have been spent in demonstrating that this territory is valuable gas-producing territory, it is worth much more than it was before this expenditure was made, independent of any deflation of the currency, and the stockholders of the Company are entitled to have back the value of the gas at the time it is taken and paid for and not merely what was paid for the territory before it was known that it would be productive of natural gas.

Also, since natural gas consumed, lost or wasted is non replaceable, the value of what is left necessarily increases as the potential supply diminishes. The margin of efficiency and economy of natural gas over other fuels is so wide as to make it certain that the available supply of the former will all eventually find a market (R., 227-9; 288; 296; 305-6). As observed by the Court in *Matter of Pennsylvania Gas Company* v. *Public Service Commission*, 211 App. Div. (N. Y.) 253, 207 N. Y. Supp. 599 (211 App. Div. at p. 261):

> "Moreover, if there is a progressively diminishing supply of natural gas in the Pennsylvania fields generally, it is difficult to see why that should not tend to enhance the value of such supply of gas as remained in the petitioner's gas fields, under the economic law of supply and demand."

As authority supporting the proposition that allowance for amortization and depreciation must be calculated on

present fair value rather than on original cost we call attention again to the decision of the Supreme Court of Michigan in *Michigan Public Utilities Commission* v. *Michigan State Telephone Co.*, 228 Mich. 658, 200 N. W. 749. That was a mandamus application brought for the purpose of compelling the Telephone Company to observe a rate prescribed by the Public Utilities Commission of Michigan. The Telephone Company responded that it ought not to be required to observe the rate because the same was confiscatory, and asserted in support of this contention, among other reasons, that allowances for depreciation and amortization were made upon the book or investment costs instead of upon present fair value. The court, in discussing this question, said (228 Mich., at p. 672):

> "Computing depreciation (although perhaps convenient to accountants and bookkeepers), on investment cost, or book cost, as distinguished from present fair value, must be rejected. If the rate base is present fair value, then the depreciation base as to depreciable property is the same thing. There is no principle to sustain a holding that a utility may earn on the present fair value of its property devoted to public service, but that it must accept and the public must pay depreciation on book cost or investment cost, regardless of present fair value. We repeat, the purpose of permitting a depreciation charge is to compensate the utility for property consumed in service, and the duty of the commission, guided by experience in rate making, is to spread this charge fairly over the years of the life of the property."

This decision accords entirely with the decisions of this Court as to the basis on which the fair return allowed a public utility must be computed. These decisions, cited in our main brief, (pp. 31-3), clearly state the rule that the compensation to which the owner of property is entitled when the same is taken for a public service is its fair value at the time

of its taking or use. This is as applicable to the return allowed for the current use of the property as it is for the return allowed for its consumption in use. The attempt of the appellees to set up a different standard for the latter than for the former is inconsistent with the principles established by these decisions. Stated in another way, their contention is no more than this: That while the appellees are using the property they must pay a reasonable return on its present fair value, but when they buy it and pay the installments of the purchase money, they need only pay the actual cost, no matter when the property was purchased. This cannot be the law.

Appellees in their briefs have cited a number of public service commission decisions which they claim establish the different standard which they advocate. However, without attempting to analyze the complicated facts of these commission decisions, it can be said that, in general, they do not establish the principle sought, and in cases where they do discuss the question and decide that amortization or depreciation should be computed on investment cost rather than on fair value, they are erroneous. There are certainly as many commission decisions holding that amortization and depreciation should be computed on fair value: See

Re Osage & Oklahoma Co. (Okla. 1917) P. U. R. 1917D 426;

Re Monarch Gas Co. (Ind. 1920) P. U. R. 1920C 960;

Re Republic Light, Heat & Power Co. Inc. (New York 1921) P. U. R. 1921C 795;

Re Hope Natural Gas Company (W. Va. 1921) P. U. R. 1921E 418;

Re Baker Natural Gas Utility (Montana 1921) P. U. R. 1921E 609;

Billings v. Billings Gas Company (Montana 1924) P. U. R. 1924C 217;

Re West Virginia Central Gas Co. (W. Va. 1924) P. U. R. 1924E 24;

Municipal Gas Co. v. City of Sherman (Texas 1925) P. U. R. 1925E 67;

MacThucaite Oil & Gas Co. v. City of Ada (Oklahoma 1927) P. U. R. 1927D 833.

This erroneous contention on which intervenors' brief proceeds of course renders its tabulations of earnings valueless, as it does its computation based thereon of the value of the Company's property.

Before leaving the question of amortization, we refer briefly to the view apparently taken in certain parts of intervenors' brief to the effect that there is only $20,981,232.11 of property to be amortized, arriving at this conclusion by the same process adopted by Commissioner Stathers, that is, by deducting from the amount found as the fair value of the property the amount of the amortization reserve of approximately $14,028,737.03 already accrued (R., 123). It is clear under the authorities that an accrued depreciation or amortization reserve is to be considered as the property of the stockholders and is not to be deducted in arriving at the rate base.

Kings County Lighting Co. v. Prendergast, 7 Fed. (2nd) 192, 202;

N. Y. Telephone Co. v. Prendergast, 300 Fed. 822 at 824, 825;

Monroe Gas Light & Fuel Co. v. Michigan Public Utilities Commission, 292 Fed. 139 at 146, 147;

Michigan Public Utilities Commission v. Michigan State Telephone Co., 228 Mich. 658, 668;

City of Elkins v. Public Service Commission, 102 W. Va. 450, 135 S. E. 297, 298.

Another controlling reason why this accrued depreciation reserve should not be deducted from the present fair value of the property in determining the amount remaining to be

amortized, is that this amount has already been consumed in deterioration of the property and in the gas already used. Mr. Hagenah finds the total value of the property, exclusive of going concern value, after applying his method of depreciation, to be $31,692,100.00.
He finds the value of the property new to be 43,114,072.00.
In each of these items he includes 6,732,920.00
for leaseholds and gas rights. If we deduct this last amount, we would have, according to Mr. Hagenah's statement, a value of the physical property new of 36,381,152.00
and a present deteriorated value, in accordance with his theory, of 24,959,180.00.
This appears from his table at pages 1166 67-68 of the record. From this it appears that the physical properties are worth $11,421,972.00 less than when they were new. The only way that this amount is returned or has been returned to the stockholders is by this depreciation reserve of $14,028,737.03. In addition to this, during the time this depreciation reserve was accumulating, there were delivered large quantities of natural gas. The value of this gas far more than makes up the difference between the $11,421,000.00 deterioration of the physical plant and the $14,028,737.03 reserve accrued. It will thus be seen that this accrued reserve has already been fully earned in the deteriorated value of the plant and in the gas delivered.

(b) *Appellees have erroneously added back into the earnings statement delay rentals on leaseholds, whereas this expenditure is for the protection of the property and should be allowed in operating expense.*

In their statement of the net earnings of the regulated part of the West Virginia business (Intervenors' brief, p. 173) appellees add back into income the sum of $147,945 as "delay rentals and leasehold expense," which had been deducted as one of the charges to operating income. This is erroneous.

These charges are uniformly made by natural gas companies to operating expense, and with reason, since they take the place during the period before development of the well rental which becomes payable upon development to the owner of the fee. The West Virginia Commission's regulations (classification of account) require them to be treated as an operating expense. These well rentals after development are always a charge to operating expense, and the delay rental which is in force during the period before development commences is its equivalent during this period and is just as much an operating expense. It is for the protection and preservation of the property and a part of the cost of furnishing the gas, and there is no justification for adding this amount back into income account.

(c) *Appellees have erroneously made additions to earnings because of sales of gas to affiliated companies.*

Intervenors' brief is confusing in that it argues sometimes from the basis of the Company's entire property, whether or not used in the public service, and the earnings accruing therefrom, and sometimes from the portion thereof in West Virginia used in the public service and the earnings accruing therefrom. Of course the latter is the only correct basis on which this case should be decided, and is the basis on which the table on page 173 of intervenors' brief is set up.

Nevertheless, in other parts of their brief, in their attempt to increase the earnings of appellant, the intervening appellees have insisted that there should be added to such earnings certain amounts because of the sale of gas to the parent companies at an average price of a little more than 7 cents. In their brief, at page 5, they show the result of increasing this price to the average price paid by other wholesale purchasing companies, which was about 19.45 cents.

In the table, at page 8, they use the figure $2,143,661.46 for 1923, and estimate that this difference should be $2,400,000.00 for 1924. The former figure is again used as

the basis of Commissioner Stathers' calculations at page 37 of the brief. The calculations made at page 39 of the brief are on the basis of raising the price of the gas sold to the parent companies to the city gate rate as found by Jirgal. This results in an increase in earnings of $1,495,496.69. This is based on the assumption that 4½ cents per thousand cubic feet is the cost of distribution, and the table at page 43 attempts to establish this at 4.6 cents instead of 4½ cents.

Appellant's contention is, of course, that there is no reason in this case for any theoretical adjustments of this character. This contention would seem to be firmly established by the cases of *Northern Pacific Railway Co.* v. *North Dakota*, 236 U. S. 585 and *Norfolk & Western Railway Co.* v. *Conley*, 236 U. S. 605, in the first of which a rate on coal was condemned and in the second a two cent passenger rate enjoined because each of these separate businesses must support themselves and not rely on the other business to make up a loss. Certainly, if a railroad company could not be required to supplement inadequate passenger rates by excess earnings on freight business, as was true in the *Norfolk & Western Railway Co.* case, or inadequate earnings from coal by excess earnings on other freights, as was true in the *North Dakota* case, for a very much stronger reason the appellant here cannot be required to supplement inadequate earnings from its public service business by profits made in its purely private business. In the two railroad cases all of the earnings were of a public character—that accrued to the railway companies from their business as common carriers, but still the court held that each class of the business must yield a fair return for the service performed. Certainly if this be true in the case of these railroads, then the appellant here is entitled to have a fair return on its public service business regardless of whether it makes excessive profits in other private business or not.

See also *Chicago, Milwaukee & St. Paul Railway Co.* v. *Public Utilities Commission, etc.*, 274 U. S. 344, 350-1.

Actual figures are available for the West Virginia public service business, and they are set up in our brief. As to the property to be assigned or allocated to the West Virginia public service business, the engineers are in agreement, and the figures are actual amounts and not the result of theoretical adjustments. The property in the production system is divided upon the basis of the gas consumed in the respective classes of business; that in the transmission system upon the basis of the demand mileage; and that in the distribution system upon the actual property used for that purpose. The expenses are divided upon a basis agreed upon by the parties, and we earnestly insist that there is no reason for attempting to test the West Virginia public service rate by earnings from business outside of West Virginia and not in anywise connected with the public service business in that State.

However, even though we assume that the whole property of the Company must be taken into consideration in testing the West Virginia rate, we respectfully submit that a test such as that made by Mr. Jirgal and by the Commission is worth nothing, for the reason that wherever it was found that gas was sold for less than the West Virginia rate the earnings were adjusted upward, but where sales were made for more than the West Virginia rate they were not adjusted downward. The only fair way to test the West Virginia rate by the whole amount of business done by the Company would be to ascertain whether, if all of the gas handled by the appellant was sold at the West Virginia rate, it would produce a fair return upon the investment. On page 1065 of the printed record, Mr. Jirgal finds that 4.5 cents is the actual cost of distribution, and that 20.27 cents is the average public service rate in West Virginia, leaving 15.77 cents as the proper gate rate; that is to say, the rate at which the gas should be calculated before being delivered to a distribution system. These calculations, it must be borne in mind, are based upon book cost of the property and not upon fair value. If based upon present values, they would be much

more. But let us even apply these figures to the total amount of gas sold by the Company during the year 1923; to wit, 46,495,459,000 cubic feet (Rec., 1134), and we would have $7,332,336.88 as the amount which would have been received for the gas had it all been sold at a rate comparable to the West Virginia rate. Of this amount of gas there was sold at retail 16,429,288,000 cubic feet. If Mr. Jirgal's distribution rate of 4½ cents be applied to this, we would have $739,317.96 which should have been received for distributing such of the gas as was actually distributed to customers, assuming that it was all distributed at the West Virginia rate. Adding this to the above figure, it will be found that the total amount which would have been received for the gas had it all been sold on a rate commensurate with the West Virginia public service rate, would be $8,071,651.84. This would represent the gross proceeds of all of the gas handled by the Company had it been sold at the West Virginia public service rate. Instead of arriving at this conclusion, Mr. Jirgal, by adjusting upward all of the gas that was sold at a lower figure than the West Virginia rate and making no adjustment for that which was sold at a higher figure, reaches a total gross earning of $9,873,837.86. The result of this, even assuming Mr. Jirgal's distribution cost to be correct, would be to reduce his gross earnings by $1,802,186.02. This calculation, as before stated, is based on the assumption that 4½ cents is a fair distribution rate. This, however, is not the case. This rate results, as before stated, from incorrect calculations. In arriving at this rate, Mr. Jirgal takes the book cost of the property instead of the present fair value. He does not include any part of the general expenses in the distribution expense. He does not include any taxes or similar charges in distribution expense. Mr. Uebelacker, on the other hand, has worked out a distribution cost including all of these items, and upon the basis of the fair value of the property as found by himself and Mr. Hagenah. This is found at page 568 of the record.

Mr. Uelselacker's figure for cost of distribution, based upon a return upon the present value of the property, is 6.825 cents. In this calculation there is no allowance for going concern value (for which Jirgal allows), which, if it was included, would make this rate more than 7 cents. If we deduct 7 cents as the fair distribution cost from the average price of 20.27 cents received in the West Virginia public service, we would have an actual gate rate upon this basis, which takes into consideration all items of expense and takes the property at its present fair value instead of book cost, of 13.27 cents.

Applying this to the total amount of gas handled during the year; viz., 46,495,459,000 cubic feet, we would have $6,169,947.41 which would have been received for this gas had it all been sold at the West Virginia gate rate. If we then apply to the 16,429,288,000 cubic feet sold in the entire public service, the West Virginia distribution rate of 7 cents, we would have $1,150,050.16, which would have been received for this gas in addition to the gate rate, which added to the amount which would have been received as the gate rate above, makes a total of $7,319,997.57 which would have been received for all of the gas handled by the appellant had it all been sold at the West Virginia rate, or $2,553,840.29 less than Mr. Jirgal's adjusted gross earnings.

The theory of the intervenors and their witnesses Hagenah and Jirgal and of the Commission seems to be that the intervenors are the owners of the property and that the appellant is simply their agent operating the same, and that any profit which is made in business carried on outside of the State of West Virginia and with other consumers of natural gas, should inure to the benefit of the West Virginia public serv-

ice consumers, while the appellant contends that it is the owner of the property and that the appellees are not concerned with how much money it makes or how much it loses on other business, but are only concerned with whether or not they are required to pay more than a fair rate for the service rendered them.

We have given the foregoing discussion of appellees' endeavor to increase earnings by adding sales of gas to parent companies, pointing out their errors, although we reiterate that these sales to private customers, not connected with the public utility business of West Virginia, should not be considered in this proceeding at all, but only the earnings from the regulated, public service end of the West Virginia business.

(d) *Appellees' Contention as to Res Judicata.*

Appellees take the position that the so-called adjustments of sales of gas by appellant to its parent companies and of the earnings from the gasoline extraction privilege were *res judicata* by virtue of the decision of the Supreme Court of Appeals of West Virginia in *Charleston* vs. *Public Service Commission*, 95 W. Va., 91, 120 S. E. 398 (Brief of intervening appellees, p. 30; Brief of Public Service Commission, pp. 34, 36). The intervening appellees cite:

New York & Richmond Gas Co. v. *Prendergast*, 10 Fed. 2nd, 167, 208;
City of New Orleans vs. *Citizens Bank of Louisiana*, 167 U. S., 371;
Guffey vs. *Smith*, 237 U. S., 101.

These authorities do not support appellees' contention.

The Court's opinion in the *New York & Richmond Gas Company* case merely holds that a valuation as of a certain date determined by a judgment in a prior action in the State Court was conclusive as to the *value of plaintiff's property*

on that date upon the successors in office of the defendants in the prior action. *New Orleans* vs. *Citizens Bank* involved an exemption from taxation, and this Court held that the parties were estopped by the judgments in two prior actions between the same parties directly upon the point. *Guffey* vs. *Smith* merely reiterates the doctrine that decisions of the highest courts of a State in which the property is situated are accepted and applied by the Federal courts as rules of property. This, it may be said in passing, is the very principle for which appellants are contending, both in this case and in No. 19, set for argument at the same time as this (p. 20, post). The decision of the Supreme Court of West Virginia in the *City of Charleston* case as to these so-called adjustments cannot possibly relate to anything beyond the state of facts disclosed by the record then before it. It is at most an adjudication that the so-called adjustments were, in the opinion of the Court, proper to be made as of the time to which the figures had been brought down. It is absurd to claim that this decision concluded appellant for all time as to the manner in which its earnings should be computed for rate-making purposes.

II.

Appellant's Gas Lands, Leases and Rights.

(a) *Appellee's Criticism of Appellant's Evidence.*

In view of the decisions of this Court and of the Supreme Court of Appeals of West Virginia, appellees are unable to contend seriously that the appreciated value of appellant's so-called gas reserves, if proven, should not properly be included in the rate base. They are obliged to content themselves, therefore, with criticising the various methods by which appellant has endeavored to prove this value.

As pointed out in appellant's main brief (p. 30) appellant has supported in three ways its contention that the various

valuations of its gas reserves reached by the majority of the Public Service Commission and by the Court below are grossly inadequate. These ways are (1) proof of the actual value of the gas in the ground based upon the calculations of an expert geologist and engineer in the most minute detail after a most thorough and painstaking examination of the properties and study of production and transmission costs and market conditions; (2) by uncontroverted evidence as to the actual price paid for natural gas in a number of contracts between parties contracting at arm's length; and (3) by the opinion evidence of practical men of the highest standing and widest experience in the business, predicated not only upon their general knowledge of the latter, but also upon their special knowledge of the very properties involved, including the nature of appellant's interest in them. All of these methods result in a value of over $30,000,000 for appellant's gas properties, or nearly three times that assigned to them by the Court below. Appellant has asserted in its main brief and still maintains that all of this evidence is reliable and uncontradicted. Appellees attack all of these methods as "estimates" and "speculative" and contend that therefore no effect whatever is to be given this evidence.

It is, of course, conceded that it is an impossibility to compute with absolute accuracy the number of cubic feet of gas ultimately derivable from the sub-surface of several hundred thousand acres of land. Neither is it possible to prophesy with certainty the market conditions which will prevail over the period necessary to extract and sell this gas. Even assuming for the sake of argument that, as charged by appellees, the estimates of appellant's witnesses Davis and Uebelacker are "mere estimates and nothing more," that is, nevertheless, no reason for disregarding them entirely in the absence of any better or surer method of valuation, and appellees have not shown that there is any better or more accurate method. Appellant still maintains that its testimony as to the value of these leaseholds is uncontra-

dicted. Appellees, at page 156 of their brief, deny this, but in support of their denial merely adduce reports and calculations of other experts which, it is submitted, are far more speculative than those of appellant's witnesses can possibly be accused of being. We beg leave to remind the Court of the check which Mr. Davis made upon his computation of the gas content by comparing it with the actual production, and of how remarkably this sustained his computation (Appellant's brief, p. 19, R., 734).

Appellees' theory, briefly summarized, is that because the value of appellant's gas reserves is not susceptible of demonstration by mathematical proof, but must necessarily be established by estimates, no weight whatever is to be given to its evidence on this point, no matter how painstaking the collection of the data upon which such estimates are based, or how well qualified its witnesses are to make them. This position, of course, cannot be supported. If precise mathematical proof of value is unobtainable, Public Service Commissions and Courts cannot, while conceding that property has value, refuse to credit it with any value whatever. They must adopt the best methods available of arriving at such value, even if these depend upon estimates or are matters of opinion.

As this Court has very recently said, in *United States* vs. *Ludey*, 274 U. S., 295, 302, referring to the difficulty of calculating depletion under the income tax provisions of the Revenue laws:

> "The fact that the reserve is hidden from sight presents difficulties in making an estimate of the amount of the deposits. The actual quantity can rarely be measured. *It must be approximated.* And because the quantity originally in the reserve is not actually known, the percentage of the whole withdrawn in any year, and hence the appropriate depletion charge, is necessarily a rough estimate. But Congress concluded, in the light of experience, that *it was better to act upon a rough estimate than to ignore the fact of depletion.*" (Italics appellant's.)

It is submitted that appellant has presented the best and only approved methods known of arriving at a just valuation of its gas properties that have yet been discovered, and certainly appellees have failed to show that better ones exist. They have attempted to suggest some at pages 159, *et seq.* of intervenors' brief, but their suggestions are arbitrary, have no sanction in business usage, and we do not think that any of them will appeal to this Court as convincing.

They begin with a suggested method of ascertaining the present day bonus cost of reproduction of the leases. This absolutely begs the question. There is no evidence whatever in the Record that the present holdings of the appellant could be reproduced. Indeed, in the very nature of things reproduction would be impossible. It is upon a careful examination of appellant's unique holdings, and upon nothing else, that the testimony of appellant's experts is based. The value claimed by appellant arises in great part from the peculiar nature and situation of these holdings, and all the testimony is to the effect that this peculiar value results from the fact that it is impossible to reproduce them. As appellant's witness Wyer testified in the Kentucky case (No. 19, R., 456), its natural gas property is "the most valuable in the world". See also the testimony of appellant's witnesses Sullivan (R., 282), Corrin (R., 287) and Gregory (R., 300) in this case.

The second suggested method is apparently based upon Judge Rose's "speculation" (R., 1265) as to whether the situation is affected by the fact that the appellant owns the gas it supplies instead of purchasing it from somebody else. It is not apparent how the consumer would benefit by the introduction of another middleman between the producer and himself. The distributor's price would necessarily be based upon what it had to pay for the gas, and the fair value of the producer's property would necessarily enter into the latter. The only effect of this suggested method is to re-

move the question of appreciated value one step further away. Also, there is no evidence that appellant will be able to purchase indefinitely such gas as it needs, in view of the decreasing quantity in existence.

Appellees' third suggestion is that if it be considered that the fair market value of gas in the ground has been established, only the value of the gas in the proven acreage can be included in the rate base. It endeavors to support this proposition by reference to the fact that the regulations of the Bureau of Internal Revenue take only proven territory into account for the purpose of computing depletion. Again, we fail to see what this has to do with the question. In imposing an income tax, Congress was under no obligation to concede to the taxpayer any allowance for depletion whatever, but might, if it had seen fit, have assessed oil and gas producers upon their full annual output.

The fourth suggestion relates to the portion of the gas reserve to be considered as presently used and useful in the public service. As pointed out in appellant's main brief (p. 37) this question was raised for the first time by the District Court in this case. We consider that appellees' argument on this head has been sufficiently anticipated, but the question is of such importance that a few additional remarks thereon may be permissible.

At page 164 of their brief, the intervening appellees quote the inquiry of their witness Hagenah (R. 446) as to what the public gains by the Company's buying this gas land if the result to it is to be as he assumes. There are two answers to this: (1) it is assured for a longer period of its supply of gas *from the same purveyor* (as, indeed, the witness admits); and (2) it would have to pay the appreciated value at any rate because the distributor would have to pay more for the gas as the supply diminished. The producer's price would, of course, include amortization of his gas supply and plant as well as its carrying charges. The alternative would be that the appellant would be forced out of business

and consumers obliged to deal with a new distributor whose costs would necessarily be enhanced either by the installation of a new system or by what it had to pay for the old one.

It is conceded by everybody that the supply of natural gas is limited, and that that which is consumed can never be replaced, so long, at least, as this planet is inhabited by the present race of human beings. Only a new creative cycle can repeat the slow geologic processes by which the gas was produced. Is it not, then, self evident that as the quantity of natural gas under ground, whatever that may be, diminishes, the value of the remainder will appreciate? It necessarily follows that the acquisition of large reserves now will lessen the cost to consumers later.

If appellant pursued the policy of merely keeping a few years' supply on hand, it would obviously have to pay higher and higher prices to maintain that reserve as time went on. This would be true, whether it acquired additional lands or leases (assuming that there were any left to acquire), or purchased from others whose costs and profits would necessarily enter into the price it would have to pay.

In its original brief, appellant cited in support of its contention that all its gas properties are presently used and useful in the public service (pp. 38-9) *Southern Bell Telephone Co.* vs. *R. R. Commission of South Carolina*, 5 Fed. (2nd) 77. The same question was before another United States District Court of three judges in *Pacific Teleph. & Tely. Co.* vs. *Whitcomb*, 12 Fed. (2nd), 279, and was decided the same way. The Court said (p. 288):

> "Public service companies cannot wait until their facilities break down or prove unequal to the demands upon them before making needful additions and improvements. Business judgment must be employed to anticipate reasonable future needs and to make provision for them in advance. This is essentially a matter of business management which may not be arbitrarily interfered with. There is nothing in the outlay to suggest dishonest, wasteful, or imprudent expenditure. The

right of a public utility corporation honestly and in good faith to carry on its business and direct its affairs must not be wrested from it under the guise of rate making. In the absence of evidence to the contrary, investments may reasonably be assumed to have been made in the exercise of reasonable judgment. Missouri ex rel. v. Public Service Commission, supra. See, also, Northwestern Bell Telephone Co. v. Spillman (D. C.) 6 F. (2d) 663."

(b) *Value of Gas Leaseholds as Such.*

The intervening appellees (at pp. 95-8) bring up again the point so elaborately discussed by Commissioner Stathers (R. 107, *et seq.*) that most of appellant's so-called gas reserves consist merely of the right, under its so-called leases, to prospect for gas and drill wells which, according to him, vest no title to the gas in the lessee until it is actually extracted. We have already pointed out (1) that the rights of the lessee under such instruments have been repeatedly held by this Court to be property—valuable property—irrespective of the question of title to the product, and (2) that the witnesses in the gas business, who testified to the value of appellant's holdings, had this precise condition in mind. Supplementing this, the Supreme Court of Appeals of West Virginia has on October 18, 1927, since our original brief was prepared, in the case of *Hall* vs. *Douglas*, expressly decided that although title conferred by an oil and gas lease is inchoate until the oil or gas is found, the lessee has, nevertheless, *by virtue of the lease alone*, a property right which is subject to taxation and for which payment must be made if the land is partitioned by sale. The opinion in this case not yet having been reported, we append it hereto.

And the United States District Court for the Eastern District of Kentucky has held that the law of that State, under the decisions of its Supreme Court, is that the grantee in an oil lease acquires ownership of the oil in the land. *Eastern Gulf Oil Co.* vs. *Kentucky State Tax Commission*, 17 Fed. (2nd) 394, 396 (citing such decisions).

(c) *Market for Appellant's Gas.*

At page 148, of their brief intervening appellees attack Mr. Uebelacker's estimated Pittsburgh price on the ground that it does not take into account the result of dumping into that market 40,000,000,000 cubic feet of gas annually. This is met by the testimony of Mr. Gregory (R., 296) that the industrial market available to his Company could be tripled if an adequate supply could be guaranteed. Judge Rose, in the Court below (R., 1266) calls attention to the fact that under the decision of this Court in *Pennsylvania* vs. *West Virginia*, (262 U. S., 553, 559) appellant cannot be forced to sell its gas in West Virginia if it can get a higher price elsewhere. If this is true—and as we have pointed out, the Record abundantly shows that appellant can readily market its entire product outside of West Virginia at much higher rates than it receives from its domestic consumers in that State—how can it be compelled to forego this profit for the benefit of the latter? It is pertinent in this connection to recall the fact that when appellant made its principal investment in West Virginia in 1909, the sale of natural gas was not the subject of public regulation in that State, nor was such the fact until 1913. Until the latter year, producers of and dealers in natural gas were absolutely free to charge as much for the commodity in which they dealt as those desiring it were willing to pay, and sound business policy justified their charging. Intervening appellees' brief (p. 158) refers to appellant's property as having been "dedicated" to the public use. It has not been dedicated. It has been commandeered.

The intervening appellees, at page 106 of their brief, attempt to make the further point that no nearby market has been pointed out "capable of absorbing plaintiff's gas in the quantities now being produced. *No gas purchasing company is suggested other than Public Utilities subject to Public Service regulation.*" (Italics appellees'.) At page 153 they at-

tempt to support this contention by citation from *Natural Gas Company of West Virginia* vs. *Public Service Commission*, 95 W. Va., 557, 568.

The statement quoted above is amazing in view of the Record in the instant case. (Testimony of Sullivan, R., 282; Corrin, R., 288; Gregory, R., 295 6; Meals, R., 305.) The testimony of these witnesses taken together demonstrates beyond peradventure that there is a very large market in neighboring States free from any Public Service regulation whatsoever which would readily absorb a vastly greater quantity of gas than appellant will in all probability ever be able to supply. Mr. Gregory even went so far as to testify that he himself would be willing to pay for an option on the property if it were for sale in the certainty that he could finance the transaction (R., 295).

III.

Additional Capital Investment in Physical Property.

At pages 84 and 85 of their brief intervening appellees discuss the question of *incomplete construction*, and argue that the Commission erred in including this item on the theory that they were considering the conditions existing in 1923. This view loses sight of the fact that rates are made for the future and not for the past. The rate prescribed by the commission was for 1925 and subsequent years as its order was not entered until March, 1925. Upon what principle, therefore, should property added in 1924 and which was being used according to the evidence be excluded from consideration in establishing a rate in the spring of 1925? As observed by this court in *McCardle* v. *Indianapolis Water Co.*, 272 U. S. 400, 408: "In every confiscation case, the future as well as the present must be regarded. It must be

determined whether the rates complained of are yielding and will yield, over and above the amounts required to pay taxes and proper operating charges, a sum sufficient to constitute just compensation for the use of the property employed to furnish the service; that is, a reasonable rate of return on the value of the property at the time of the investigation and for a reasonable time in the immediate future."

Respectfully submitted,

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APPENDIX.

No. 6021

R. C. Hall

vs.

L. A. Douglas,
United Fuel Gas Co. *et al.*

Roane County — Reversed in part, and Remanded.

Litz, Judge.

(Syllabus.)

The lessee of a cotenant of mineral estate in land is entitled to be paid for the value of his lease out of the proceeds assigned to his lessor, upon partition of the minerals by sale.

Litz, Judge:

This suit was instituted for partition of 11½ acres of oil and gas land, situated in Roane County, and owned by the parties as follows: ½ of the mineral and surface by the plaintiff, R. C. Hall; ½ of the surface by the defendant, L. E. Garrett; and ½ of the mineral by the defendants L. A. Douglas, R. R. Douglas, Ufa Douglas, Hallie Douglas Adams, Ethel Townsend, Vera McKown, J. B. Vineyard and Flora Vineyard, subject to a lease for oil and gas to the defendant United Fuel Gas Company. The answer of the United Fuel Gas Company avers that it will cost more than the value of the gas to drill a well on the land; that "the only way in which the rights of the parties in the oil and gas and other minerals thereunder can be preserved is to sell the same and divide the proceeds"; and prays in the alternative for dismissal of the bill or sale of the minerals and distribution of the proceeds among the parties in interest.

By decree of June 27th, 1925, the circuit court "adjudged, ordered and decreed that the surface only of said land can be partitioned in this suit". This Court upon a former appeal affirmed that decree, in so far as it directed the partition in kind of the surface only, and remanded the cause for sale of the oil and gas and distribution of the proceeds among the parties in interest. *Hall* v. *Douglas*, 102 W. Va. 400. Thereafter, by decree of January 18th, 1927, the circuit court directed a sale of the oil and gas and distribution of the proceeds; and pursuant to said decree the oil and gas were sold, May 7th, 1927, to L. G. Davis for $9,500.00. May 23rd, 1927, the United Fuel Gas Company filed a petition alleging that on July 30th, 1926, it drilled a producing gas well upon a tract of 150¾ acres of land, embraced in its lease of the 1½ acres; and praying in the alternative, that the sale be set aside and the interest of the petitioner in ½ of the oil and gas underlying the 1½ acres be determined before ordering another sale, or that "if the court is of the opinion that it can determine the interests of the parties herein without setting aside said sale and said decree, that then, before said fund is distributed, it first ascertain and determine the interest of this petitioner in said fund, and in any decree distributing the same direct that such part of said fund be paid to it as will correspond to its interest in said land under said lease". A decree was entered May 28th, 1927, confirming the sale and denying the United Fuel Gas Company the right to participate in the proceeds. Appealing from that decree, the United Fuel Gas Company assigns the following as grounds of error:

(1) The entry of the decree of sale before determining the interests of the parties in the oil and gas, and the absence of proof that the interests of all the parties would be thereby promoted.

(2) The denial to the plaintiff of the right to participate in the proceeds of sale, and the directing of payment of one-half thereof to J. P. Young, a stranger to the suit.

The decree involved in the former appeal specifically determined the interests of the parties in the oil and gas, as well as the surface of the 1½ acres of land. The appellant, having averred in his answer that the only way in which the rights of the parties in the oil and gas could be preserved was by sale and division of the proceeds, is not in position to question the propriety of the sale; nor is it prejudiced by the decree complained of, in so far as payment of one-half of the proceeds of sale is directed to J. P. Young, as assignee of the plaintiff R. C. Hall. The appellant, however, is prejudiced by the decree denying it the right to participate in the proceeds from the sale of the interest in the oil and gas belonging to the defendants L. A. Douglas, R. R. Douglas, Ufa Douglas, Hallie Douglas Adams, Ethel Townsend, Vera McKown, J. B. Vineyard and Flora Vineyard, and the decree, appealed from, to this extent will be reversed, and the cause remanded for the purpose of ascertaining the value of its lease, and of directing payment thereof from the proceeds derived from the sale of the interest of said defendants. Although title conferred by an oil and gas lease is inchoate until the oil or gas is found, the lessee has, nevertheless, by virtue of the lease alone, a property right which is subject to taxation in this state.

Reversed and remanded.

FILED
OCT 23 1928
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1928.

No. 4.

UNITED FUEL GAS COMPANY

v.

THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA, BIRK S. STATHERS, *et al.*

APPELLANT'S REPLY BRIEF TO APPELLEES' SUPPLEMENTAL BRIEF.

JOHN W. DAVIS,
HAROLD A. RITZ,
DOUGLAS M. MOFFAT,
EDWARD L. PATTERSON,
Counsel for Appellants.

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UNITED FUEL GAS COMPANY

v.

PUBLIC SERVICE COMMISSION OF WEST VIRGINIA, BIRK S. STATHERS, *et al.*

No. 4.

APPELLANT'S BRIEF IN REPLY TO APPELLEES' SUPPLEMENTAL BRIEF.

Upon the hearing of this case on the 15th inst. Appellees filed a supplemental brief. At the close of the argument on the 16th, the Court gave leave to Appellant to reply to this supplemental brief if it desired to do so within one week and, in view of the fact that the supplemental brief presents some of the propositions involved in a different way from that which was heretofore presented, we have taken advantage of the leave granted by the court to reply thereto.

Proper Rate of Amortization.

Protestants make the same argument, directly or inferentially, which they made in their principal brief, that only a part of the plaintiff's gas reserves are to be taken into the rate base. Whether this part is limited to the so-called proven territory, for the reason that proof as to the remaining territory is considered too speculative, or whether, as the Court below decided, the part should be limited to that presently used and useful in the public service, without the necessity of deciding whether the proof of value of the whole is adequate, the result is the same, namely, that only such

part is taken into the rate base as will be sufficient to supply the needs of the plaintiff's system at its present rate of consumption for five years (R., 1263, 1264). In our principal brief we said (pp. 54, 63-65) that if this position should be conceded for the sake of argument, the present rates would be seen to be confiscatory more clearly than on any other theory considered, for the reason that the amortization rate to be applied to plaintiff's amortizable property, would be, not the eighteen year amortization rate of 3.9%, but the five year amortization rate of 18.46%. The table showing our calculation of the confiscatory character of rates under this percentage is set out on pages 64 and 65 of our principal brief. To this the protestants have merely answered (pp. 168 and 183 of their principal brief) that while it may be fair to apply the 18.46 percentage amortization rate to the gas fields, it is unfair to apply this five year rate to the plant but that this should be amortized as before by the lower eighteen year amortization rate, and that if this is done the rates are not confiscatory. Their argument is that notwithstanding that the gas fields taken into the rate base will be exhausted at the end of five years, yet as the plaintiff has an eighteen year reserve, it should continue to call on this, so that this reserve will be moved forward year by year thus continuing to ensure always a five year supply until exhaustion of the reserves, and that during all of this time the plant would continue to function. This argument is unfair in the highest degree. If plaintiff is to be required to hold gas lands in reserve for the purpose of keeping down to the lower percentage its amortization rate on its plant, it should be allowed the valuation of all these reserves in its rate base. It is most unjust to say that it has no reserves that are worth anything for the purpose of the rate base and yet to say that it has reserves which are worth the great sum necessary to justify the maintenance of the expensive plant and that it must continue to hold these reserves in the public service for the full term of eighteen years, for the purpose of keeping down the amortization rate. This imposes on the plaintiff

the duty of holding for the public service an eighteen year reserve of gas and yet allowing it a return on only a five year reserve. One of two things must in justice be granted to the plaintiff. First, if it is to be allowed in its rate base the value of only a five year reserve, then it should be allowed in income account an amortization rate which will amortize within five years not only that reserve, but also the plant which is of no value when the five year limited supply is exhausted, for it is obvious that a gas plant without gas is of such small value that it can for practical purposes be disregarded. Or, secondly, if it is to be limited to charging for its amortization of plant to an eighteen year rate of amortization on the ground that its gas reserves will keep the plant going for eighteen years, it should be allowed in its rate base the value of the full eighteen-year gas reserves. Whether the protestants' argument in favor of limiting the gas reserves taken into the rate base to five years is based on the argument of lack of proof beyond a period of five years or from the argument that, though proved sufficiently, only a five year supply can be said to be used and useful in the public service, the result is the same; if gas reserves are considered sufficiently proved to limit the plaintiff to an eighteen year amortization rate on its gas plant for the reason that it is clear that the gas reserves will be there for eighteen years, the gas reserves must be considered as sufficiently proved to be taken into the rate base at the same rate of value as the rest of the gas lands; and stated from the other point of view, if the company is to be limited in the rate base to a five year supply of gas, it should be entitled to amortize at the five year rate not only the gas but also the plant whose usefulness is gone when the gas supply is gone. Protestants' argument, however, does neither of these things but decides both of them to its own advantage, considering the gas reserves as sufficiently valuable to justify the amortization of the plant only over an eighteen year period but not sufficiently valuable to allow anything for them in the rate base;

and this also was the decision of the court below, from which this appeal has been taken.

In this connection, to prevent misunderstanding, reference might be made to one observation of the Court below, to which protestants have also alluded, to the effect that the five year supply of proven gas territory would be sufficient, if limited to supplying the public service customers of the Company, to meet their requirements for a quarter of a century (R., 1264). It must not be thought that this would justify the use of the lower, or eighteen year, amortization rate for the plant. If we assume that this supply of gas which the Court below held to be used and useful in the public service is all to be allocated to the regulated service for the purpose of extending the life of that service and keeping down the amortization rate, then the whole value of these gas reserves, and not merely the percentage of them representing the West Virginia public service business, must also be allocated to that service, and if we do this the value attributable to the public service in West Virginia would be largely in excess of what is claimed by the appellant. That is to say, instead of adding $2,590,677 as the proportionate part of the gas reserves allocated by Judge Rose (R., 1273) to West Virginia, there should be attributed thereto the total value found by Judge Rose, to wit: $10,317,311.39 (R., pp. 1272-3). Then if in Judge Rose's table of computation (R., p. 1272), there be substituted for the figure $2,590,677, as the value of gas reserves, the entire value of the gas reserves, that is, $10,317,311.39, we would have a total value of property used in the West Virginia regulated business of $18,978,033.39, and there is no theory of the case, however fantastic, that will produce a fair return upon this valuation. We do not understand that the observation of the Court above referred to is intended to contest this, but we mention the fact to avoid misunderstanding.

The Merchant Theory.

In the Reply Brief filed by Appellees at page 11, there is a discussion of what is termed the Merchant Theory, the

suggestion being that, inasmuch as the Appellant is not only furnishing service but is also selling a product, a price should be fixed for its product which would be charged into its expenses as a Public Service Corporation and then it be allowed a fair return on the property used in distributing this product to its customers. The argument is stated that a merchant engaged in business furnishes himself with a stock of goods, and expects to sell those goods to his customers and make a fair profit on the whole stock as well as interest on the investment that he has therein. A fair application of this theory gets us nowhere in this case. The property of the Appellant, comparable to the stock of goods of the merchant, is its gas reserves and if, as in the case of the merchant, it is entitled to sell its stock of goods so as to get a fair return upon the investment therein or the value thereof, we have reached exactly the same point as a practical matter that we now occupy, for it is clearly shown that the gas reserves, which we might call the stock of goods from the merchant theory, are no more than a sufficient stock for the purposes of the business in which the Appellant is engaged. (Testimony, John B. Corrin, R., p. 289; Testimony, T. B. Gregory, R., p. 296; Testimony, T. O. Sullivan, R., p. 283). It will thus be seen that any calculation which contemplates selling each unit of the stock of goods on hand at exactly what it cost or at its exact value leaves out of consideration the requirements of Appellant to keep on hand a large supply of its product to meet the demands of its customers.

We repeat our contention that property which constitutes a reasonable and no more than a reasonable supply for future needs fairly to be anticipated is as much devoted to the public service and as justly entitled to a present return as property of any other character.

Proven and Probable Territory Are Not Segregated.

The argument of Appellees might be susceptible of the construction that the territory which Mr. Davis characterizes as

probable territory is remote from and disconnected with the territory indicated as proven. An examination of the record and of the very elaborate report made by Mr. Davis, however, shows that a large part of this territory called probable lies contiguous to and within the boundaries of proven territory and it is not classified as proven simply because a well has not been drilled within the distance that Mr. Davis considers is necessary to determine with absolute certainty that it is underlaid with gas. The court's attention is invited to his very complete and elaborate report which constitutes Volume 2 of the Record. The maps clearly indicate the location of the various classes of the territory and the report gives in detail his reasons why he thinks each piece of land should be given the classification that he has affixed to it. This report and these maps also show the location of all the wells which have been drilled, whether by the Appellant or someone else within the territory and the record of these wells, both as to productivity and original rock pressure. Mr. Davis's testimony (R., pp. 229, *et seq.*) contains a very full explanation of the method used in making up the maps referred to, as well as his report.

Attention is called to his testimony at page 243 where he was testifying, as he states, two years after he made the report in December, 1923. He instances the fact that since he made that report the Appellant and other companies drilled 215 wells in the territory which he had classified as probable and that of these 190 were productive and 25 were dry holes, indicating that his discount of 38% was excessive. He also states (p. 242 of the Record) that a considerable proportion of the territory which he classified as possible at the time he made the report in December, 1923, has, by the drilling of wells, since become probable and the territory which he classified as probable at the time he prepared the report in December, 1923, is now proven territory; that many an engineer would regard the territory indicated by him as probable to be proven territory, and that he regards it as proven from the standpoint of wells that have been drilled and proven productive.

Valuation by Practical Gas Men.

The valuation of appellees' gas reserves by practical gas men is criticized by appellees and it is insisted that this testimony is not worthy of consideration. One of the reasons for this suggestion by appellees is that it appears that all of these witnesses are interested in the gas business and are, therefore, prejudiced. Of course, this does not justify the exclusion of the evidence. It goes to its weight and not to its admissibility. It would be an unusual condition indeed if a witness could be procurable who would have the qualifications necessary to testify intelligently to the valuation of this property who was not engaged in the natural gas business either at the time of giving his testimony or at some time in the past, and we think that this testimony, instead of being discredited because the witnesses showed such familiarity with such property, should be given peculiar weight on that account. Another suggestion made for discrediting this testimony is that the conclusions reached by these witnesses are said by appellees to be based on what the gas could be sold for in a regulated market in other states. The exact opposite is the case. An examination of the testimony of these witnesses will indicate that instead of basing their value on what the gas could be sold for in a regulated market they were very careful to state that their judgment as to its value was based upon what could be procured for it in an unregulated market, and that there was such an unregulated market. As to the witness Sullivan (R., p. 282), he says, after fixing the value of the property at $34,000,000 and giving the basis upon which he arrived at that value:

> "That in fixing the value which he did on the gas reserves of the United Fuel Gas Company he has in view a free market in which the price received by the gas would not be affected by public service rates; that he had in mind such markets in the States of Ohio and Pennsylvania through gas lines which are already installed and some of which are already connected."

Upon this question, the witness Corrin (R., 288), after giving his opinion as to the value of the property, says:

> "that the gas produced by the United Fuel Gas Company could be entirely marketed, without relation to any state regulatory control or public utility commission control and that looking at the matter from that standpoint alone, and excluding the use of the gas by state regulated utilities, he still thinks the property is worth the amount given by him;"

The witness Gregory, at pages 295-6, shows that his value is based upon sales which might be made of the gas, after being produced, in markets in the territory extending from Buffalo, New York, down to Pennsylvania; that he knows that there are such markets, *and that this business is not under the regulation of public service commissions*, for the reason that the company of which he is the head is now supplying a large part of those markets.

In presenting this evidence as to the value of these properties from these witnesses, practical gas men, familiar from their business with the value of such gas lands, we were following the doctrine laid down by this Court in numerous cases that the value of real estate or rights in real estate is properly provable by the opinion evidence of men qualified by experience to pass on such a question; see, especially, *Montana Railway Company* v. *Warren*, 137 U. S. 348, 354, a case of proving the value of a mineral claim, the headnote of which is in part as follows:

> "In a proceeding under the right of eminent domain to condemn, for use in the construction of a railroad, an undeveloped 'prospect' in mineral land, the testimony of a competent witness, familiar with the country and its surroundings, as to the value of the land taken, may be received in evidence, inasmuch as such property is the constant subject of barter and sale, although its absolute and intrinsic value may be uncertain before development."

If there was other evidence of value to the contrary to contradict the evidence of these highly qualified witnesses, the appellees had ample opportunity to produce it and should have produced it.

Interstate Commerce.

In their reply brief, appellees insist that the Court cannot consider that any of appellant's wholesale business is interstate commerce, asserting that there is no evidence in the record that such is the case, and deduce from this supposed fact the doctrine that the West Virginia Public Service Commission has the right to regulate this business, although it has not done so. Whether the public service commission has the right or the power to regulate appellant's wholesale business we consider beside the point. It has not done so and, having left the appellant free to contract in regard to this business, we insist that it cannot now be considered as affecting rates fixed by the commission for the regulated business. And it must always be remembered that the allocation of property between the regulated and unregulated service is based on volume or volume by distance (demand mileage) and not on revenues.

However, the appellees are mistaken in the statement in their reply brief that there is no evidence that any of this wholesale business is interstate commerce. The evidence is direct and uncontradicted that the deliveries to the parent companies, the major part of this wholesale business and the part about which appellees are making so much complaint, is all interstate commerce. The witness H. A. Wallace (R., p. 347), testified that the gas delivered to the Ohio Fuel Supply Company and the Columbia Gas & Electric Company, which are the parent companies referred to by appellees, is for consumption in Cincinnati, Ohio, and Columbus, Ohio. Further than this, this Court has already determined in the case of *United Fuel Gas Company* v. *Hallanan*, 257 U. S. 277, that this very gas of this very company is interstate commerce.

Respectfully submitted,

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Supreme Court of the United States

OCTOBER TERM, 1927.

No. [redacted] 4 : 7

UNITED FUEL GAS COMPANY,
Appellant,

vs.

THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA, BIRK S. STATHERS, ERNEST D. LEWIS, *et al.*

BRIEF ON BEHALF OF INTERVENING APPELLEES, THE CITIES OF CHARLESTON AND HUNTINGTON, et al.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1927.

UNITED FUEL GAS COMPANY, Appellant, vs. THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA, BIRK S. STATHERS, ERNEST D. LEWIS, *et al.*	No. 79

BRIEF ON BEHALF OF INTERVENING APPELLEES, THE CITIES OF CHARLESTON AND HUNTINGTON, ET AL.

PART ONE.

HISTORY OF CASE AND STATEMENT OF ISSUE.

I.

THE QUESTION INVOLVED

The question involved is the constitutionality of the order of the Public Service Commission of West Virginia of March 24th, 1925, canceling the schedule of increased rates filed by the plaintiff gas company, and continuing in effect rates formerly approved by the Commission and attacked by the company in this suit as confiscatory. The plaintiff says that its property is being taken from it for public use without just compensation, and asks an injunction to restrain a continuance of the taking. The defendants, the Commission and the intervening cities,

deny the complaint of the company on the ground that the rates now in effect furnish an ample revenue for a fair return, operating expenses, depreciation, amortization and all other charges to which plaintiff is lawfully entitled

II.

THE DECISION OF THE COMMISSION

The case before the Commission, in its broad outline, was a typical rate controversy, with the duty cast upon the Commission of fixing a rate base, fair return, proper allowances for depreciation, amortization and a schedule of rates to carry such findings into effect. The opinion of the Commission referred to in its order complained of (R. 143) was written by Chairman Stathers (R. 82), and it is his opinion to which we refer as the opinion of the Commission.

Commissioner Divine concurred in the order, canceling the Company's schedule of increased rates, but disagreed with Chairman Stathers upon certain points not controlling, for reasons stated in a memorandum filed by him (R. 134). Commissioner Lewis dissented from the order of the Commission upon three grounds stated in a dissenting opinion filed by him (R. 139).

The properties of the plaintiff, a natural gas company, fell naturally and logically into two classes: the physical or tangible property, consisting of its pipes, buildings, machinery, and other equipment, and its gas rights, consisting chiefly of leases of many thousands of acres of land, mostly in the State of West Virginia, in part producing leases, and in part leases held by payment of an annual delay rental for the purpose of future drilling and production. The Commission determined the value of both of these classes, physical property and gas rights, together with certain allowances for going value and working capital, to be the rate base.

1.—Rate Base

Upon consideration of the use to which the property was put, the book cost, the estimated historical cost, the reproduction cost new less depreciation estimate, and applicable decisions of the state and federal courts, the Commission fixed the present fair value of the different elements of the property as follows:

Classification	*As of Dec. 31, 1923*	*As of Dec. 31, 1924*
Physical Property	$25,000,000.00	$25,648,457.72
Working Capital	990,000.00	990,000.00
Going Concern Value	3,000,000.00	3,000,000.00
Leaseholds	6,343,329.67	6,361,511.42
TOTAL	$35,333,329.67	$35,999,969.14

Except in the case of the value of the gas rights, which was based upon the book cost, that being in the Commission's opinion the fairest and most reliable evidence of value presented (R. 117), this valuation of plaintiff's property was determined upon a consideration of all of the evidence submitted by both parties.

Commissioner Divine was of the opinion that the rate base, including $666,000 for additions in the year 1924, should have been $41,165,000.00, made up as follows:

Physical Property	$26,660,000.00
Working Capital	990,000.00
Going Concern Value	3,000,000.00
Leaseholds	10,500,000.00
	$41,165,000.00

Having determined the rate base, the Commission next proceeded to consider the adequacy of the earnings of the

Company under the existing schedule of rates to pay a fair return thereon, after making proper adjustments and deductions.

2.—Net Earnings Available for Return

(A)—EARNINGS AND EXPENSES

The gross revenue of the Company for the year 1923 was $7,730,176.40. The operating expenses and taxes for that year were $3,734,802.82 (R. 132).

Certain adjustments were made by the Commission both in the earnings and expenses of the Company as shown by its books, in order to ascertain the net earnings available for return on the fair value found by it. These adjustments were:

(1)—CREDIT FOR USE OF GAS FOR THE PURPOSE OF GASOLINE EXTRACTION

The plaintiff's two stockholders below mentioned, own all of the capital stock of the Virginian Gasoline & Oil Company, to which company plaintiff granted the privilege of extracting the gasoline from its natural gas production. The Commission, following the ruling of the Supreme Court of Appeals of West Virginia, determined that 50% of the net earnings from gasoline manufactured should be added to the earnings of the plaintiff, to compensate it for the use of the facilities jointly used and added to the earnings of the plaintiff the sum of $934,393.41 for the year 1923.

(2)—ADJUSTMENT FOR GAS SALES TO PARENT COMPANIES

The Columbia Gas & Electric Company and the Ohio Fuel Supply Company own all of the capital stock of the plaintiff. The plaintiff during the year 1923 sold more

than one-third of its total gas supply to these two companies, at an average price of 7.279 cents per M cubic feet. In calculating the revenue of the company for that year, the Commission, again following the decision of the Supreme Court of Appeals of West Virginia, added to the plaintiff's earnings the difference between the revenue actually realized from the sales to the parent companies and the value of the same amount of gas based on the rates paid by comparable wholesale purchasing companies. This adjustment added to the earnings of the plaintiff the sum of $2,143,661 46.

(3)—OTHER MINOR ADJUSTMENTS

Certain other minor adjustments, consisting principally of a proportion of the joint expenses chargeable to other departments of its business, and profit and loss adjustments which were not carried by the company through its current accounts, were made by the Commission, in the amount of $187,533 93. (R. 132.)

(B)—DEPRECIATION AND AMORTIZATION

The Commission adopted the view of the plaintiff's engineer, Mr. Uebelacker, that depreciation is "simply an allowance for the equalizing of the annual expenditures for keeping the plant in condition to perform 100 per cent service." (R. 120.) To this end it allowed for depreciation 1.5 per cent of the book cost of all plaintiff's properties, equivalent to 1.12 per cent of the rate base, which for the year 1923 amounted to $404,333. In view of the fact that for the preceding fourteen and one-half years the company's average annual expenditure for depreciation was only $203,463.61, the allowance of the Commission was generous. (R. 128.)

Amortization is defined by the Commission as an annual allowance for the eventual retirement of the *present value*

of the leaseholds and operating plant (R. 120). While recognizing that amortization should be calculated over the entire life of the plaintiff's property, both past and future, the Commission did not undertake to estimate the amortization accruals prior to the period during which the company was subjected to public service regulation. It, therefore, commenced with the year 1916, the first year for which the Commission fixed a depreciation and amortization rate for this company. (Case No. 482, 1 P. S. C. W. Va. Dec. 238.) For the years 1916-1918 the rate fixed for both of such items was 6%. For the years 1919-1922 the rate was 8.6%. These rates, calculated on the respective rate bases then established, resulted in accumulations for depreciation and amortization during the entire period 1916-1923 of $16,788,210.12 (R. 123). Calculating the depreciation at 1.5% of the book cost during this period, and deducting the amount so found ($2,759,473.09) from the sum already found for both depreciation and amortization, the Commission found that the remainder, or $14,028,737.03, represented the reserve for the accrued amortization of the property (R. 123).

It is to be noted that this accrued amortization applies for the period from 1916 to 1923, and does not take into account in any way the accrued amortization for the period from 1909 to 1916, during which period the Commission was not in existence, or no rate litigation was before it. The Commission was created by an act of the legislature of West Virginia passed in 1913.

The Commission having found that the present fair value, including going concern value, but deducting working capital, should be the basis upon which amortization should be calculated, and having also found that the company, since regulation began, had been allowed for accrued amortization the sum indicated above, determined that a rate of 4.15% applied to the present fair value of the property would be sufficient, over the remaining life of plain-

tiff's property, to accumulate a reserve equal to such fair value. As hereafter shown, this figure of 4.15% was applied by the Commission to the fair value of the plaintiff's property, found by it to be $35,999,969.14, and not to the amount of $20,981,232.11 (present value less amortization reserve, $14,028,737.03) which appears in the Commission's decision. In other words, the Commission merely established the amount of $20,981,232.11 in order to assist it in determining what should be the proper amortization rate for the future. It also considered in this connection "the probable additions for the next five years". Chairman Stathers and Commissioner Divine differed sharply here, the former holding that the Commission should apply the amortization allowance to the present value, while the latter agreed with the protestants that amortization is for the retirement of investment and that the allowance therefor should be applied to the book cost.

(C)—REASONABLE RETURN

Considering the nature and claimed risk of the business, and the value of the service, a return of 8% upon the rate base was allowed (R. 130).

In the statement below, there is summarized the findings of the Commission on the various revenue and expense items above mentioned:

Classification	*Year Ended Dec. 31, 1923*	*Year Ended Dec. 31, 1924 (Estimated)*
Gross Revenues	$7,730,176.40	$7,770,000.00
Operating Expenses and Taxes	3,734,802.82	3,890,000.00
Net Earnings per Books	$3,995,373.58	$3,880,000.00
Add:		
Value of Gasoline Extraction Privilege	$ 934,393.41	$ 520,000.00
Additional Amount due on Parent Company Sales	2,143,661.46	2,400,000.00
Miscellaneous Adjustments	187,533.93	
Net Earnings available for Depreciation, Amortization and Return	$7,260,962.38	$6,800,000.00

(R. 133.)

3.—Percentage Available for Return, Depreciation and Amortization

It appears from the foregoing that the Commission approved allowances of 1.12% for depreciation, 4.15% for amortization and 8% for fair return, or a total net return of 13.27% upon the rate-base. It found the Company actually earned, in the year 1923, 20.55%, for these items, and in the year 1924, 18.89%, both of these percentages being figured on the present fair value of the property, as determined by it. Nevertheless, the Commission did not reduce the rates of the Company to the point where they would yield only the return found to be reasonable. The

bearing which this fact has on the question of confiscation is next pointed out

4.—Available Earnings Allowed by the Commission Capitalized at 8% to Show the Effective Fair Value of Plaintiff's Property

As already indicated, the amount found by the Commission as available for return, depreciation and amortization was, for the year 1923, $7,260,962.38, and for the year 1924, $6,800,000.00 (estimated). As will appear later, the effective amount allowed by the Commission for depreciation and amortization was $1,899,537.00, (5.27%, on fair value of $35,999,969.14) so that under its decision the amount available for return would have been as follows:

Classification	*Year Ended Dec. 31, 1923*	*Year Ended Dec. 31, 1924*
Net Earnings available for Depreciation, Amortization and Return, as above	$7,260,962.38	$6,800,000.00
Allowance for Depreciation and Amortization	1,899,537.00	1,899,537.00
Net Earnings available for Return	$5,361,425.38	$4,900,463.00

It will hereinafter be pointed out under the discussion of depreciation and amortization, that the allowance made for these items by the Commission was largely in excess of the actual requirements of the Company. However, assuming for the present the propriety of the allowance, **the above earnings, available for return, if capitalized at 8%, would have resulted in an effective rate base**

valuation by the Commission for the year 1923 of $67,000,000.00, and for the year 1924 of $61,250,000.00, instead of the rate base of $35,333,329.67 and $35,999,969.14, respectively determined, as heretofore stated.

Commissioner Divine's findings as to the net earnings available for return are set forth in tabular form below (R. 139):

Gross Earnings		$ 9,225,673.00
Add 50% Gasoline Net Earnings		934,393.00
TOTAL GROSS EARNINGS		$10,160,066.00
DEDUCT:		
Operating Expenses and Ordinary Taxes	$ 3,343,450.00	
Income Tax	312,346.00	
Amortization and Depreciation 3¼% on rate base of $41,165,000.00	1,337,862.00	
		4,993,658.00
NET EARNINGS AVAILABLE FOR RETURN		$5,166,408.00*

**Decision shows $5,227,408.00 evidently in error as details support above amount.*

Commissioner Divine concurs in Chairman Stather's views as to the adjustment of gasoline earnings, but differs with him upon the amount of the adjustment for gas sold to the parent companies and the allowance for amortization and depreciation. However, his final conclusion as to the net earnings available for return, after considering all of these items, is not materially different from that arrived at by Chairman Stathers. (Stathers, $5,361,425; Divine, $5,166,408.) **Capitalization of the net earnings determined by Commissioner Divine at 8% results in an ef-**

fective fair value of plaintiff's property of $65,000,000.00.

The third member of the Commission, Mr. Lewis, while disagreeing with both Commissioners Stathers and Divine as to the valuation of the leaseholds, amortization and depreciation and the amount of the adjustment to be made for sales of gas to parent companies, made no specific findings as to any of these matters nor as to the rate base or net earnings.

Each of these adjustments hereinbefore mentioned made by Commissioners Stathers and Divine for gasoline and for sales of gas to parent companies, as well as the allowance made by them for depreciation and amortization, is hereinafter separately discussed, and are, we submit, sustained by the evidence. The point we make at this time is that if this Court agrees with the District Court that the findings of the Commission upon these matters is sound, then the plaintiff's net earnings available for fair return upon the fair value of its property devoted to the public use, when capitalized at 8%, produces a value or rate base of $67,000,000, according to Chairman Stathers, and $65,000,000, according to Commissioner Divine, both of which figures exceed the valuation of plaintiff's said property, including therein the increased value of its leaseholds, alleged in its bill of complaint. The bill alleges that the total fair value of plaintiff's physical property, including going concern value and working capital is $34,621,996.57 (R. 14), and that the present fair value of its gas rights "is at least the sum of $30,000,000" (R. 16). This is all the property involved. This makes a total valuation or rate base claimed by the plaintiff of $64,621,996.57. It, therefore, appears that the amount of plaintiff's net earnings available for return to its stockholders, when capitalized at 8%, produces a valuation or rate base in excess of that alleged by the plaintiff.

Both Chairman Stathers and Commissioner Divine allowed to remain in operating expenses, $589,180.00, representing delay rentals and leasehold expenses for 1923.

If this amount be added to net earnings and capitalized at 8%, it will add $7,300,000.00 to the rate base, making the Stathers rate base $75,000,000.00 and the Divine rate base $72,300,000.00. See post p. 14 and p. 55.

III.

DECISION OF THE DISTRICT COURT IN THIS SUIT

The plaintiff filed its bill in the District Court of the United States for the Southern District of West Virginia, in which it sought an injunction to restrain the enforcement of the order of the Public Service Commission of West Virginia denying plaintiff an increase in rates. The District Court having refused a temporary restraining order, the application for an interlocutory injunction, pursuant to section 266 of the Judicial Code, was heard before Circuit Judge Rose and District Judges McDowell and McClintic. On May 18, 1925, the majority of that Court held (R. 1275), that the application for an interlocutory injunction should be denied. (*United Fuel Gas Co. v. Public Service Commission*, 14 Fed. 2d 209.) In the majority opinion, rendered by Judge Rose, found at page 1229 of the Record, it was stated that the maximum value of the property upon which plaintiff was entitled to a return *did not exceed* $40,307,311.39, made up of the following elements:

Physical Property	$26,000,000.00
Working Capital	990,000.00
Going Concern Value	3,000,000.00
Leaseholds	10,317,311.39
TOTAL	$40,307,311.39

(R. 1266.)

On the matter of net earnings available for amortization (exclusive of depreciation) and return, the court made the following finding:

Net Earnings per Books	$ 3,995,802.82
Add:	
Value of Gasoline extraction privilege	934,393.41
Additional amount due on Parent Company Sales	2,143,661.46
Miscellaneous Adjustments	187,533.93
Total Above Items	$ 7,261,391.62
Deduct:	
Depreciation Allowance	404,333.00
Amount Available for Amortization and Return	$ 6,857,058.62

(Record 1238-9)

In arriving at these net earnings, the court approved the adjustment made by the Commission for the use of gas and gas facilities in the manufacture of gasoline, as well as the adjustment for the sale of gas to the parent companies. It *reduced* the Commission's allowance for amortization from 4.15% to 3.65%, which it termed "a generous allowance" (R. 1236).

Capitalizing said net earnnings ($6,857,058.62) at 11.65%, the rate found to be necessary for fair return and amortization (8% for return, 3.65% for amortization), Judge Rose found that the earnings under existing rates resulted in an effective valuation of $58,858,872.27 (R. 1239), when the sales to parent companies are adjusted on the basis of the average sales price to similar wholesale purchasers, the method adopted by the Commission, or an effective valuation of $53,295,228.84 if such

sales be adjusted on the basis of sales to retail consumers, a difference of method which subsequently will be considered in greater detail

The District Court did not pass upon the question whether the delay rentals, amounting to $589,186.00, were properly deducted from earnings by the Commission as an operating expense, indicating doubt as to the propriety of such deduction, but the Court did state that if this item were not properly chargeable to such operating expenses, an addition of $5,000,000.00 to each of the foregoing valuations would result (R. 1271-2). As will appear later, this is the position taken by the protestants.

The plaintiff contends in this suit that the regulatory power of the West Virginia Public Service Commission applies only to the retail business in that State. Without passing upon that question the District Court made a finding as to the value and earnings applicable to the retail business in the State of West Virginia. It found that the fair value of plaintiff's property used in that business was not in excess of $11,251,499.00 (R. 1273), that the earnings applicable to return and amortization amounted to $1,441,935.00 (R. 1272). These net earnings, when capitalized at 11.65% (allowance for return and amortization), result in a value of $12,377,124.42. This is $1,125,624.12 in excess of the fair value applicable to West Virginia retail business. **Accordingly in the opinion of the Court there was no confiscation, even if the West Virginia retail business were considered as a separate enterprise.**

We call attention to the fact that if the delay rentals, as the protestants contend, are not a proper operating charge, the amount of this item properly charged to the West Virginia retail business, $147,945.00, consistently with the findings of the Court, will add an additional million dollars on which the applicant is earning reasonable return and amortization, so that the excess on this basis for the West Virginia retail consumers is over

$2,000,000.00, rather than the $1,125,624.12 found by the Court.

Further the District Court used a combined percentage of 11.65 for amortization and return in capitalizing net earnings to find the effective fair value of plaintiff's property. Its use assumes that all items of fair value are subject to amortization, while a number such as working capital, land, local distribution systems and the large element of salvage are not. The correct method would have been to find the reasonable and proper allowances for depreciation and amortization, deduct them from net earnings and capitalize the balance on the basis of a reasonable rate.

The same issue of confiscation and substantially the same questions involved in this suit were raised by the bill filed by the plaintiff against the Railroad Commission of Kentucky, *United Fuel Gas Company* v. *Railroad Commission of Kentucky*, 13 Fed. (2d.) 510. The opinion of that court was rendered by Judge Hickenlooper April 22, 1925. Judge Hickenlooper fixed the rate base upon which the Company was entitled to earn a reasonable return at $37,015,764, made up as follows:

Physical Property including overheads	$26,283,844.00
Working Capital	999,000.00
Going Concern Value	3,000,000.00
Leaseholds	6,732,920.00
	$37,015,764.00

IV.

SUMMARY OF FAIR VALUES FIXED BY THE WEST VIRGINIA COMMISSION AND THE FEDERAL COURTS

The findings of the several tribunals which have determined the fair value of plaintiff's property involved in this suit are:

Classification	Public Service Commission of West Virginia		District Court for Southern District of West Virginia	District Court for Eastern District of Kentucky
	Chairman Stather's Opinion*	Commissioner Dunn's Opinion	(Judge Rose)	(Judge Hickenlooper)
Physical Property	$25,648,457.72	$26,666,000.00	$26,000,000.00	$26,283,844.00
Working Capital	990,000.00	999,000.00**	990,000.00	999,000.00**
Going Concern Value	3,000,000.00	3,000,000.00	3,000,000.00	3,000,000.00
Leaseholds	6,361,511.42	10,500,000.00	10,317,311.39	6,732,920.00
TOTAL	$35,999,969.14	$41,165,000.00	$40,307,311.39	$37,015,764.00

*Value stated as of December 31, 1923 was $35,333,329.67, but the Commission evidently considered 1924 plant additions in all its calculations (See R. 132-133).

**Evidently an error as all witnesses accept the figure of $990,000.00.

The maximum difference between the four tribunals as to the total fair value of the property is approximately $5,000,000, or only about 14% of the lowest value fixed. Commissioner Stathers and Judge Hickenlooper held that the book cost was the best evidence of the value of the Company's gas rights, while Commissioner Divine and Judge Rose, giving consideration to the evidence of the Company as to the appreciation in value of the gas rights, gave a value to such rights higher than the book cost, as hereinafter more fully developed.

We understand that in a confiscation case the specific findings of fair value become relatively unimportant if the record shows that the earnings derived from the property at existing rates, when capitalized on the basis of a reasonable return, result in valuations much higher than such specific findings. It must be kept in mind that the existing rates, though found by the Commission to yield more than an ample return, were not reduced to the point where they would yield only a fair return on the valuation established.

For a summary showing the result which obtains if the amount of net earnings is capitalized at the respective percentages found by the Commissioners and the District Court as reasonable for return—or for return, depreciation and amortization combined, in comparison with the specific finding of fair value made in each instance; see page 49 post.

The effective valuations indicated by this capitalization method range from $53,300,000.00 to $74,300,000.00. As heretofore stated, the present fair value alleged in plaintiff's bill is $64,621,996.00, or perhaps $66,070,496. (R. 7.)

The controlling question, therefore, before this Court in this suit is not whether the fair value determined by the Commission or the District Court is inadequate, but whether the value produced by capitalizing the net earnings derived from existing rates, upon the basis of a reasonable return, equals or exceeds any reasonable fair value sustained by the evidence. If so, there can be no confiscation.

The protestants contend that neither the Commission nor the Courts erred in finding too low a value, and that, on the contrary, the very highest estimate of fair value supported by the evidence was as follows:

Physical Property	$23,969,180
Working Capital	990,000
Going Concern Value	3,000,000
Leaseholds at Book Value	6,732,920
Total	$34,692,100*

**See Hagenah's Exhibits 1 (R. 1108) and 10 (R. 1228). Exhibit 1 is exclusive of going concern value which item witness testifies is $3,000,000, and which is added in Exhibit 10.*

As there is but slight difference between the parties as to the valuation of the physical property, and as the Commission accepted the so-called book cost as the value of the leaseholds, there is little difference between the protestants' claim and the Commission's finding in arriving at

the value of plaintiff's property for the purpose of fixing the rate base.

The protestants contend, however, that there was substantial error in the Commission's findings as to the net earnings available for return. Instead of the net earnings found by Commissioner Stathers, $5,361,425.38, or $5,166,408.00, found by Commissioner Divine, protestants claim that the net earnings available for return were at least $5,694,229.00, as shown below:

Gross Earnings	$10,160,067
Operating Expenses and Taxes	3,655,797
Net Earnings available for Depreciation, Amortization and Return	$ 6,504,270
Deduct—Depreciation and Amortization computed on Original Cost of Property	1,399,277
Net Earnings after Depreciation and Amortization	$ 5,105,043
Add Back—Delay Rentals on Unoperated Leaseholds and Leasehold Expense	589,186
Net Earnings available for Return	$ 5,694,229*

**See Jurgal Exhibit, I. J. C. No. 1 (R. 1161).*

This amount of net earnings, when capitalized at 8%, results in a valuation of $71,177,000, which is in excess of any estimate of fair value claimed by the plaintiff.

This statement of net earnings differs from the Commission's findings in respect of:

(a) The adjustment for parent company sales.

(b) The basis for computing annual depreciation and amortization.

(c) The exclusion of the delay rentals and leasehold expenses from operating costs.

Each of these adjustments will be discussed later.

PART TWO.

ARGUMENT

V.

STATEMENT OF NET EARNINGS

The two fundamental propositions upon which protestants rely, which will be developed in this brief, are:

First—Since the value arrived at by the capitalization of net earnings under existing rates equals or exceeds the present fair value of plaintiff's property as claimed by it, there can be no confiscation of plaintiff's property even though the Court may be of opinion that the Commission erred in its determination of the fair value of plaintiff's property, constituting the rate base found by the Commission.

Second—That there is, in fact, no error in the fair value of plaintiff's property as found by the Commission, but to the contrary, such valuation is more than liberal to the plaintiff.

The only problem involved in the first proposition is the proper statement of the earnings. Four questions were raised before the Commission as to the proper amount of the net earnings available for return on investment, namely:

1. The credit for the value of the gasoline extraction privilege.
2. The adjustment for parent company sales.
3. The allowances for depreciation and amortization.
4. The propriety of including lease rentals and lease expenses in the operating expenses.

1.—The Proper Credit for the Value of the Gasoline Extraction Privilege

In approaching the gasoline question, it is necessary to understand something of the nature of the business of extracting gasoline from natural gas, and its history as applied to the instant case.

The plaintiff, in 1916, began the extraction of gasoline from natural gas by processes developed at that time. The gas flows from the fields through the transmission lines and compressor stations to the gasoline extraction plants where the gasoline is taken out. The residual gas is redelivered to the transmission system for transportation to its ultimate destination. There is, therefore, joint use not only of the gas itself but also of certain facilities of the company, for the production and transmission of gas for utility purposes and for gasoline manufacture. If an independent gasoline producer wished to extract gasoline without entering into the business of selling gas for commercial and industrial purposes he necessarily would have to provide these facilities in order to secure the gas which is necessary in the extraction process. In other words, he would have to invest in gas acreage, gas wells and the necessary gathering and transmission pipe lines in order to bring his gas to the gasoline plant. Of necessity, he would have to incur the royalty payments on the gas, delay rentals on his leaseholds held in reserve, the cost of operating and maintaining the well supply and the cost of operating and maintaining the gathering lines and transmission system. A number of independent gasoline producers do this very thing.

Because of the fact that the plaintiff, in rendering its public utility service, already has these facilities, it is possible to use them jointly for utility and gasoline manufacturing purposes. This joint use of the facilities referred to calls for pro-rating of joint investment and expenses.

In the extraction process the primary essential is the gas itself. In view of the fact that it has been possible up to this time to extract gasoline from natural gas at a very much cheaper cost than to extract the same from crude oil by the so-called "cracking" process, the extraction privilege is very valuable. The evidence shows (R. 412) that over 90% of all gasoline produced is made from crude oil, so that the market price of gasoline is governed by the cost of production of the crude oil producer. Since the cost of producing gasoline from crude oil is much higher than the cost of extracting it from natural gas, the value of natural gas, as the raw material for the latter process, has increased substantially.

Originally the United Fuel Gas Company engaged directly in the gasoline extraction business. While so engaged, its application for a rate increase, designated by the Commission as Case No. 585 (*Re Application United Fuel Gas Company*, 1 P. S. C. W. Va. Dec. 501, P. U. R. 1918 C. 193) was considered by the Commission. In its opinion rendered February 28, 1917, it carefully considered the relation of the manufacture of gasoline to the gas utility business. At the end of the year 1916 the company had an investment in its gasoline business of $280,000 and its net earnings for the first six months of the year 1917 were $732,000. The Commission gave careful consideration to the method used in the business and the effect thereof on the residual gas. It was the contention of the company that the gasoline business was an independent enterprise not to be considered in the fixing of its gas rates, also that the extraction of the gas cleansed the gas and thereby protected fittings in the transmission lines from disintegration. Protestants, on the other hand, contended that since the company as a public utility had acquired certain rights and privileges not enjoyed by private corporations, and used its plant jointly in the distribution of gas and the manufacture of gasoline, the gasoline investment should be charged to gas investment

and the earnings therefrom credited to production expense, or that a proportionate part of the gas production based upon the ratio of the value of the production for gasoline and gas purposes, as reflected by the respective earnings from each business, should be charged to the gasoline business. Protestants' position was founded to a considerable extent upon the evidence of Mr. Halford Erickson, whom the Commission quoted as follows:

> "The gasoline business in this instance is essentially a part of the gas business. Whether or not the heat unit contents of the gas is materially lowered does not alter the fact that the gasoline station is essentially dependent upon the existence of the gas in mains for its own existence. A close analogy is found in the artificial gas utilities where the earnings from the sale of residuals are either carried as earnings or credited to production expense. * * * To treat the net gasoline earnings as a credit to production expense seems most equitable and least likely to lead to incorrect results."
>
> (*Re: Application United Fuel Gas Co.*, 1 P. S. C. W. Va. Dec. at page 518.)

The Commission stated that it did not wholly subscribe to the theories advanced by either of the parties. It took the position that the manufacture of gasoline from natural gas was rather a "use" than a "consumption" of said gas. It said that the only correct method of treatment was to credit to production and transmission expense "*the fair value of the use of the gas production per unit of volume used in the process of the manufacture of gasoline*." It took into consideration the evidence showing that 1,000,000 cubic feet of gas would produce 162½ to 165 gallons of gasoline, with the result of a loss of 30 cubic feet of gas in volume per gallon of gasoline and of from 15 to 22 heat units, and with the further result that the remaining

gas was cleansed and improved in quality. It appeared that the average cost of manufacture of gasoline, including royalty and a return upon investment, was from 6 to 10 cents per gallon. Assuming that the total volume of production for 1916 passed through the company's gasoline extraction plants, it appeared that it had the use of 39,000 million cubic feet of gas, which earned a net return of approximately $300,000.00, or about $7.70 per million cubic feet.

In considering the value of this use, the Commission noted that it had been shown in a recent case (*In re Application of West Virginia Central Gas Company*, 1 P. S. C. of W. Va. Decisions, 455) that "the privilege of extracting gasoline from the gas produced by that company has been granted to Hope Natural Gas Company *upon a royalty basis of fifty per cent of the output*." In other words, the Hope Company provided the entire investment necessary for the extraction of gasoline and paid voluntarily the producing company one-half of the output (gross earnings) for the privilege of using its gas in the manufacture of gasoline.

Taking all the facts into consideration, the Commission held that "one-half the net earnings is the proper measure of the value of the gas so used." The Commission used the following language which is of peculiar significance in connection with the subsequent efforts of the company to avoid the effect of this decision by the organization of the Virginian Gasoline & Oil Company and its attempt to sell or lease to it said gasoline rights, as hereafter stated:

> "In our opinion it is the duty of the utility to sell the use of its gas in the gasoline process for its reasonable value as if dealing with a stranger at arm's length. In other words, a gas utility *should not be permitted to sell the use of its gas to itself for a private enterprise* for less than its fair market value, or the price that could be obtained if said

production should be offered upon the open market. The reasonable value of that use is the measure of the earnings from that source that should be properly credited to the production and transmission expense. * * * We are justified in concluding that, measured upon the basis of net earnings from gasoline production as above set forth, the value of the privilege of using applicant's gas for the production and extraction of gasoline is equal at least to one-half of the net profits arising out of the business, and that earnings from this source should be properly credited to applicant's production and transmission expense. We so find."

(All italics in this brief are ours.)

After stating that the basis announced did not establish a controlling precedent and that a different conclusion might be reached upon a proper showing of facts, the Commission added:

"We realize that the basis here fixed is somewhat arbitrary, but in the absence of exact facts and figures we have endeavored to so adjust our conclusions as to be sure of doing no injustice to the applicant." (p. 522.)

Plaintiff renewed its contentions with respect to gasoline earnings in its case No. 845 (1 P. S. C. W. Va. Dec. 651, P. U. R. 1920 C 583), but the Commission, in its decision of December 19, 1919, said that no evidence had been offered sufficient to justify a change of its position in regard thereto.

The issue was a third time raised in case No. 1251 (Bulletin 70, decided April 28, 1922) and the Commission again affirmed its conclusion that the reasonable value of the use of the plaintiff's gas production for the purpose of gasoline extraction was one-half of the net earnings

from the gasoline manufacture. It relied upon its two former holdings in the United Fuel Gas Company cases and particularly upon its case of *In re: Hope Natural Gas Company*, (Case No. 663, 1 P. S. C. W. Va. Dec. 839, P. U. R. 1921 E. 418), where it used the following language:

> "It is unprofitable to produce or purchase gas for the sole purpose of extracting the gasoline content therefrom, and that inasmuch as a certain volume of the gas is consumed in the process and the heating value also slightly reduced, thus imposing a burden upon the gas business, the gas consumers are entitled to some proportion of any net earnings arising therefrom. In that case (*Re: United Fuel Gas Company*, Case No. 585) we fixed the measure of the reasonable value of the use of natural gas for the purpose of extracting the gasoline content therefrom by applying the terms of a contract made between the Eastern Oil Company and the Hope Natural Gas Company. We found this value in that particular case to be one-half the net earnings arising from the business."
>
> *In re: Hope Natural Gas Company*, P. U. R. 1921 E. at p. 429.

The reference to the contract between the Hope Natural Gas Company and the Eastern Oil Company is significant as indicating the value put upon the extraction privilege by two parties dealing at arm's length.

In order to avoid the effect of these decisions, on May 1, 1922, the plaintiff caused to be organized the Virginian Gasoline & Oil Company, a West Virginia corporation. It conveyed to the newly organized company all of its gasoline manufacturing properties and certain oil rights, in consideration whereof the Virginian Company issued to

the plaintiff all of its capital stock and assumed $1,717,000 of the plaintiff's outstanding bonds. On the same day plaintiff made a contract with the Virginian Company, the essential provisions of which, so far as the present issue is concerned, were:

1. That the Virginian Company should have the exclusive right to extract gasoline from natural gas produced by the plaintiff.

2. That all residual gas should be redelivered to plaintiff's lines free of charge, and

3. That in consideration for the extraction privilege, the Virginian Company should pay to the plaintiff *one-eighth* of the gross proceeds from the sale of the gasoline manufactured.

On June 22, 1922, plaintiff transferred all of the Virginian stock to the Columbia Gas & Electric Company and the Ohio Fuel Supply Company, the holders of all plaintiff's capital stock, herein frequently referred to as its "parent companies".

The foregoing inter-relations of the plaintiff and the Virginian Gasoline & Oil Company fully appear in the record of Case No. 1251—which case and record therein were, upon motion of the plaintiff, consolidated with the present proceeding before the Commission (R. 83)—as well as from the opinion of the Supreme Court of Appeals of the State of West Virginia in *City of Charleston* v. *Public Service Commission*, 95 W. Va. 91, at page 125, below referred to.

Plaintiff contends that its contract with the Virginian Company provides an adequate compensation for the extraction privilege. It so contended before the Commission in the second hearing of its Case No. 1251 (Bulletin No. 82, P. U. R. 1924 A 357). The Commission, as then constituted, (Commissioner Divine, dissenting) held that the contract of May 1, 1922, between the plaintiff and the

Virginian Gasoline & Oil Company, was valid. It was from this decision of the Commission that the protestants, including the City of Charleston, the City of Huntington, and others appealed to the Supreme Court of Appeals of the State of West Virginia. That court, the court of last resort in the State, definitely rejected the Commission's latest ruling, and unanimously approved the three earlier decisions of the Commission.

The opinion of Meredith, President, contains a full discussion of the whole question. The court's answer to the statement of the Commission that one-eighth of the gross earnings from gasoline "may exceed one-half the net revenue derived from the operation of the gasoline properties", is conclusive. (Opinion, p. 123). The answer was the following tabulation based on actual sales during the period, 1917-1922:

Division of one-eighth of the gross and one-half of the net revenue:

	One-eighth gross	*One-half net*
1917	$239,374.25	$ 669,955.28
1918	289,275.18	799,235.37
1919	361,801.17	1,093,650.60
1920	451,813.76	1,340,810.35
1921	344,510.52	1,032,759.80
1922	379,007.13	1,171,752.22

The foregoing tabulation is substantially the same figures as are shown in "Jirgal Exhibit No. 8", R. 1158-1160.

The holding of the court upon the validity of the alleged sale of the gasoline extraction privilege by the plaintiff to the Virginian Gasoline & Oil Company is sufficiently stated in points 6 and 7 of the syllabus of the court:

> "6. The reasonable value of the use of the natural gas production of a public service company for

the purpose of the manufacture of gasoline therefrom, as shown in the present case, is fifty per cent of the net income derived from the production and sale of the gasoline."

"7. Where in a rate case it is shown that a natural gas utility company has caused a corporation to be formed and has transferred to it, with other property the exclusive right to use all its natural gas for the purpose of extracting gasoline therefrom and receives therefor all the capital stock of the new corporation and is to receive as royalty one-eighth of the gross proceeds of the gasoline as it is produced and sold, and it appears that half the net proceeds therefrom annually amount approximately to three times the eighth of the gross proceeds, such a sale, so far as the gas consuming public is concerned, is unfair; it is a sale made by the company, with the company, and for the benefit of the company, and should be ignored in determining the proportion of the income from gasoline which should be charged to the utility."

The State Supreme Court reversed and set aside the order and findings of the Commission and remanded the case to the Commission for such further investigation and action in accordance with the decision of the court as should be proper. Pursuant to this order the Commission proceeded further to investigate the value of the gasoline extraction privilege. Its conclusion, after considering the testimony introduced before it was stated by Chairman Stathers (R. 130), as follows:

"Our examination leads us to the conclusion that under the facts in this present record, considered together with the facts in the record of Case No. 1251, we must reach the same conclusion as that at which the Supreme Court of Appeals arrived. The

> record supports and compels a finding agreeable to said holding, so that, using the language of the court, 'We think the extraction privilege is worth at least fifty per cent of the net profits and that proportion should be charged to the gas business'"

This position was expressly approved by Judge Hickenlooper in the Kentucky case, as allowing "a most generous return on the value of the property used for extraction purposes" and "in no wise unreasonable." (*United Fuel Gas Company* v. *Railroad Commission of Kentucky*, 13 Fed. (2d.) 510.)

Judge Rose's finding upon this point was as follows:

> "We do not find it necessary to consider whether the issue there passed on is now *res adjudicata* because even if it is not, we are as to it of one mind with the highest court of the State." (R. 1237.)

For the year 1923, one-half of the net earnings from gasoline extraction amounted to $934,393.41. One-eighth of the gross earnings amounted to $876,732.57. (Data based on Jirgal Exhibit No. 8, R. 1158.)

Protestants contend that said holding of the highest court of the State is the law of this case.

> *New York & Richmond Gas Co.* v. *Prendergast*, 10 Fed. (2d.) 167, 208.
> *City of New Orleans* v. *Citizens' Bank of La.*, 167 U. S. 371.
> *Guffey* v. *Smith*, 237 U. S. 101.

Apart from the application of the principle of *res adjudicata*, protestants submit that the finding of the Commission as to the value of the gasoline extraction privilege is amply sustained by the evidence adduced before it

in the present proceeding. Two points developed by the evidence deserve special consideration, namely:

1. The joint use of the facilities by plaintiff and the Virginian Gasoline and Oil Company.

2. Valuation of the extraction privilege, as measured by ordinary principles governing the valuation of such privileges.

Mr. Jirgal, witness for the protestants, gave as his reason for crediting 50% of the gasoline net profits to the Gas Department the following (R. 412):

> "That the reason for assigning one-half of the net profits from the gasoline business to the natural gas business is that, in the first place, there is a joint use of facilities. The gas is taken out of the ground from acreage that costs the company money; that gas is transmitted or gas is also taken out of the ground through wells that also call for an investment; the gas used is piped to the gasoline station; the acreage which is called upon to yield the gas costs the company considerable every year in rentals, for which the gas department is assessed; royalties are paid; it costs something to operate and build a transmission system, and that would seem to call for a division of those items between the two projects. The exact amount of the money is rather difficult to ascertain, but some division it would appear would have to be made. The cost accounting principle is not to consider one of two major products as a residual product, and the other as bearing all the cost. Some fair division has to be made between the two major products. Now then, looking at it from the purely economic side, you have this situation, that from 90 to 95 per cent and possibly more of the gasoline in this country is manufactured from the crude oil refining process.

That means that the crude oil refinery will, in a fair competitive market, determine the price because it will be that cost of production which will determine the price on which they can sell their gasoline at a profit. Now, that makes it a question of relative costs between the natural gas gasoline process or the natural gas extraction process and the crude oil process, and as long as there is a differential the natural gas producers will get the difference in profit. Now you are giving him a very large differential advantage, when you do not assign any costs at all for the raw product he uses in the manufacture, and that is natural gas. In the crude oil process, as I understand it, there are a great many economies being perfected, and the cracking process I understand is being made more efficient. That means that the margin between the natural gas extraction process and the crude oil process will decrease, if the natural gas process does not also become more efficient. Now the records of the company show, as I recall them, that each year there is a gain in the amount or yield per thousand feet, which goes through the gasoline extracting station. So it shows that that method is becoming more efficient, but it is a question as to which process is becoming relatively more efficient. Anyone going into the question of extraction from natural gas would therefore be willing to pay the natural gas producer that price which would allow him to meet the crude oil refiner's price. In other words, he would pay that much more for the natural gas rights or for the right to extract from natural gas the amount represented by the difference in his cost of production and the cost of production by the crude oil refiner. He wouldn't pa, absolutely that differential, because he would be taking all the risks of the manufacture and he would be taking

the risks over a series of years, and of course he would want some leeway because he wouldn't want to take all the risks and get nothing of the gain going into it, but that would be the principle that would determine how much he would pay for that right. Now, in the previous hearing I have attempted to show, from figures of the Federal Trade Commission, that that right would be more valuable than the fifty per cent. Whether or not these figures would obtain at this time, I am not able to say, but the principle would govern just the same, and if there is no differential there would be nothing to split. I think the question is merely a question of determining a fair basis for paying for the right or privilege of extraction to the natural gas producer."

Jirgal credited 50% of the net earnings of the gasoline end of the business to the Gas Department in all of the exhibits presented before the Commission. It appears (R. 413) that he had previously made a study of specific data from the bulletins of the Federal Trade Commission, which show that the privilege of extracting gasoline from gas was worth at least three cents per thousand cubic feet, which, based on the sales, sustained a credit of more than 50% of the gasoline net earnings.

Mr. Krebs, a consulting geologist and mining engineer of Charleston, who testified with respect to contracts between parties dealing at arm's length, with which he was familiar, providing for the extraction of gasoline from natural gas, stated that it was his opinion that the value of the extraction privilege was at least 50% of the net profits from the sale of the gasoline. (R. 489.)

Mr. Hagenah, for the protestants, by his "Exhibit No. 9" (R. 1226 and 1227), showed an assignment to the gasoline

department of its proportion of the joint investment and expenses. This exhibit of Mr. Hagenah is, we submit, conclusive that the 50% division of the gasoline net earnings is more than liberal to the applicant. Mr. Hagenah showed that of the total joint expenses, $607,562 was assignable to the gasoline department, and that of the total reproduction cost less depreciation of the joint physical property, $5,185,939 was assignable to the gasoline end of the business. Using these findings of Mr. Hagenah as a basis, the expenses of which the gas department should be relieved by the gasoline department would be as follows:

Operating Expenses	$ 607,562.00
Fixed Charges (on gasoline proportion of joint property—($5,185,939) representing depreciation, amortization and return of 8% on investment—all estimated at 13.27% by the Commission)	688,174.00
Total Gas Department Costs Assignable to Gasoline Department	$1,295,736.00

On the basis of this statement of expense allocation the Commission very properly could have credited to the gas department $1,295,736.00 instead of its credit of $934,393.00, a difference of $361,343.00.

Jirgal's Exhibit "No. 8" (R. 1158) shows that for the year ended December 31, 1923, the gasoline end of the business had net earnings of $1,868,786.82 after taking into consideration all prior charges including depreciation and federal income taxes. If from these net earnings there is deducted the $1,295,736.00 of costs which were borne by the gas department, but which should have been borne by the gasoline department, the latter business would have a net earning of $573,050.00 available for return on the gasoline investment of $1,167,397.00, *or over forty-nine per cent.*

That a credit of one-half of the gasoline net earnings to the gas department for the extraction privilege has been more than fair to the gasoline department is shown by "Jirgal's Exhibit No. 8", (R. 1158), which is summarized below:

Year	*Investment in Gasoline Plant at End of Year*	*50% of Gasoline Net Earnings Retained by Gasoline Department*	*Per Cent Return on Investment Earned by Gasoline Department after paying 50% for Extraction Privileges*
1916	$ 279,980.77	$ 127,676.13	45.60
1917	437,678.87	662,446.51	151.35
1918	525,999.83	791,519.38	150.48
1919	752,970.03	1,103,637.70	146.57
1920	938,347.34	1,320,292.99	140.70
1921	989,852.22	999,587.21	100.98
1922	1,073,483.50	1,101,705.72	102.63
1923	1,167,397.25	934,393.41	80.40

In no single year since 1916 (the first year in which the extraction took place) has the return on the gasoline investment, represented by 50% of the net earnings, been less than 80.40%. It is inconceivable that in a free-competitive market the Virginian Gasoline & Oil Company could earn any such profits as these, provided it paid for its gas on the basis of the full value of the gasoline extraction privilege. The Commission, therefore, has been exceedingly liberal in valuing the gasoline extraction privilege at only 50% of the gasoline net earnings.

The only serious contention, apparently, made by the plaintiff relative to the gasoline credit is that it is abnormal. In other words, the claim is made that the credit of $934,000 made by the Commission will not represent the

normal credit which can be expected on this account. This contention is answered by the statement introduced immediately above, in which it is shown that in no year since 1919 has the 50% credit amounted to less than that amount ($934,939.41). As to applicant's contention that the 50% rule results in a fluctuating credit, the Court has only to review the amounts for the last five years to see that such fluctuations are not any greater than could be expected in normal operations of any business of this character. Protestants claim that the fluctuations have not been so marked that the Commission could not rely upon the application of its rule in determining the proper amount of the

While the credit applicable to the year 1924, as shown by the record (R. 1160), is lower than many of the preceding years, the testimony of Mr. Hagenah showed that the gasoline conditions in that year were not abnormal, but subnormal (R. 452). The data already introduced above shows that this is the case. It appears from Uebelacker's testimony that the price of gasoline had nearly hit bottom in 1924 (R. 226). The Commission used 1924 prices for its adjustment for that year, reducing its allowance for 1924 to $520,000.00. That the Commission's estimate was accurate is demonstrated by the fact that the total earnings from the gasoline business for 1924 proved to be $1,066,110.32. (Plaintiff's brief, p. 60, R. 1066.)

The price of gasoline is not the only factor in the determination of gasoline net earnings. Hightower's chart (R. 987), referred to at page 60 of plaintiff's brief, shows that the price of gasoline had fallen from 25.73c per gallon in 1920 to 14.86c per gallon in 1923, or about 10.87c, equivalent to 42%. During the same period the net earnings of the gasoline department decreased only 29% (from $2,640,585.00 to $1,868,786.00, R. 1158). In 1921 with gasoline at 19.92c a gallon, the net earnings

were only slightly higher than in 1923 when gasoline was selling at the low price of 14.86c. In 1922 with gasoline selling at 18.42c per gallon, the net earnings of the Virginian Gasoline & Oil Company were actually higher than in 1921 when the price was 19.92c. (Hightower, R. 987.) Price is only one of the many factors which influence operating results.

The protestants, in summary of this question, contend, (1) that the principle of crediting one-half of the gasoline net earnings is *res adjudicata* in the State of West Virginia, (2) that even if this be not true, the credit is more than supported by an allocation of the investment and expenses of the joint facilities used in this connection; and (3) that the fairness to the applicant of the 50% principle is supported by the testimony before the Commission.

It is significant that none of the Commissioners in this case questioned the fairness of the 50% division, and it is not surprising that Judge Rose in his opinion should have concluded his consideration of the subject by approving the finding of the highest court of the state.

2.—The Proper Allowances for Parent Company Sales.

Commissioner Stathers adjusted plaintiff's earnings by adding thereto the sum of $2,143,661.46. (R. 132), representing the difference between the grossly inadequate amount actually realized from the sale of 17,613,173,000 feet of gas during the year 1923 to its two parent companies (7.279c per M cubic feet) and the value of the same amount of gas based upon sales to its other wholesale buyers. As indicated by Judge Rose (R. 1238), plaintiff had never seriously contested the propriety of an adjustment for these sales prior to filing its brief in this Court. The figure adopted by the Commission was based

upon the calculations of Mr. Nease, the Commissioner's statistician, designated by Chairman Stathers as "Nease Exhibit No. 12", (R. 132) and which was not included in the printed record. The Commission has uniformly required such an adjustment, and its holding upon this point received the definite approval of the Supreme Court of Appeals of West Virginia in this same proceeding, *Charleston v. Public Service Commission*, 95 W. Va. 914, where the Court said:

> "It will be recalled that the two parent companies, the Columbia Gas & Electric Company and the Ohio Fuel Supply Company, respectively, own 51% and 59% of the capital stock of the United Fuel Gas Company. The company for several years had been selling gas in enormous quantities to these and other gas companies at wholesale rates. For the most part, these sales were made under special contract. * * *
>
> The rate to the Columbia Gas & Electric Co. and the Ohio Fuel Supply Co., the parent companies, has been very low; for 1922 it was 7 cents per thousand. During the same year the Hope Natural Gas Company paid 15.51 cents and the Pittsburgh & West Virginia Gas Company paid 16.83 cents, or an average on their total of 15.7 cents. The commission held that the company was not receiving sufficient from its two parent companies, and the revenue received from them should be increased by at least $1,000,000, in other words, these two companies should help make up any deficiency in revenue. Protestants claim that the $1,000,000 increase is not sufficient, viewed in the light of the quantities of gas sold, that these two companies should pay at least as much as the average price charged the Hope Natural Gas Company and the Pittsburgh & West Virginia Gas Company. If

this were done, the two parent companies would have paid for the gas sold them in 1922 $1,463,398.93 more, instead of $1,000,000 more under the old rate. Without discussing in detail these various special contracts and the supply furnished these various companies during the cold weather months, we think it clear that the Hope Natural Gas Company and Pittsburgh & West Virginia Gas Company in practical effect enjoy no special advantages over the Columbia Gas & Electric and Ohio Fuel Supply; hence the two latter companies should pay as high a rate as the two former. By so doing it increases the amount to be paid the utility, at least in accounting $1,463,398.93 more than the amount fixed by The Commission. *The record shows that a very considerable part of the company's investment has been made to supply these wholesale customers and they should bear their share of the burden.*"

Plaintiff's bill does not attack the adjustments further than to intimate that the Commission, after making the adjustment, dealt unfairly with the plaintiff in failing to separate its so-called public service sales from its profitable wholesale business, a proposition which protestants challenge, and to the answer of which a section of this brief will be devoted.

The average price which plaintiff charged the Columbia Gas & Electric Company and the Ohio Fuel Supply Company, two public utilities, for the year 1923 was 7.279 cents per M cubic feet. Other comparable wholesale buyers paid an average of 19.45 cents (R. 138). The difference measures the extent of the preference in price accorded plaintiff's affiliated companies.

Protestant's witness, Jirgal, filed exhibits based upon a different method of calculating this preference. Instead of comparing the price to the parent companies with the price charged similar buyers, he compared it with the

average price charged the West Virginia retail purchasers, after deducting the cost of operating the distribution system, a branch of the plant not necessary for selling gas to wholesale buyers. This distributing cost he found to be 4.5 cents per M cubic feet, which he deducted from the average retail price, 20.27 cents, and arrived at the figure of 15.77 cents (R. 1065) as representing the price of gas delivered to parent companies if those companies should be placed on the same basis with West Virginia retail consumers. On this basis the adjustment amounted to $1,495,496.60 (R. 1065). Commissioner Divine adopted this theory of calculating the adjustment. This is the adjustment which was used in the computation of the gross earnings of $10,160,067, for the basis of calculating net return and from which we arrived at a capitalized effective valuation of plaintiff's properties of $71,177,000. (Ante, p. 19.) Had we used the Commission's adjustment of $2,143,661.46, there would have been increase in earnings of $648,164.77, and the capitalized value would have been increased to $79,000,000.

Plaintiff does not contend that the price charged the parent companies is a fair price, although admitting they are preferred in the deliveries of gas. (Wallace, R. 347, 356.) Indeed, it is much less than Mr. Davis' estimate of the value of the gas in the ground. What it does contend is that so long as it serves its "public service consumers" it can do as it pleases with the rest of its gas. (Plaintiff's brief, p. 57), and infers that the Commission has attempted to manage its private affairs in much the same manner as did the State of Kansas in its regulation of the wages of the employees in the meat packing industry. The isolated language quoted by plaintiff from Mr. Chief Justice Taft's opinion in *Wolff Packing Co. v. Court of Industrial Relations*, 262 U. S. 1110, is an inhibition against the regulation of wages by the State in a purely private business. The proposition here presented is the duty of a public service company whose entire business is devoted to the public

use, and long since clothed with a public interest, to deal fairly with its patrons and to make only such contracts with affiliated corporations, as proper discretion, good faith and sound business judgment dictate.

> **"Though a court will not generally substitute its own judgment for that of managing officers of utility company concerning contracts for supervision and special service, such rule is inapplicable where there is common control of both utility company and party with whom it contracts."**
>
> Syl. Pt. 53, *Idaho Power Co. v. Thompson*, 19 Fed. (2d) 547, (1927).
>
> *State of Missouri, ex rel., Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U. S. 276.
>
> *Harrisville v. Imperial Oil & Gas Co.*, 96 W. Va. 315.
>
> *Jamaica Gas Light Co. v. Nixon*, 181 N. Y. Sup. Ct. 623.
>
> *Ohio Mining Co. v. Public Utilities Commission* (Ohio) 140 N. E. 143.

As will later appear, plaintiff acquired many hundreds of thousands of acres of gas leaseholds in the year 1909, and a considerable amount each year up to the present time. During this entire period the public, in the rates paid by them, have paid in the form of operating expense the carrying charges and rentals without which these leases would have been lost to the plaintiff, the amortization and depreciation charges to retire plaintiff's properties upon their exhaustion and a fair return upon the value of its entire physical plant and gas rights. In its several applications to the Public Service Commission it uniformly has presented its estimates of value of its property devoted to public use, which included all of its property of every kind. Never until now has it presented to any court or

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commission the argument that but about one-fourth of its property is devoted to public service. It could not do so. Its miles of pipe lines, its pumping stations, its wells, its gas leases are an indivisible whole, invested with a public interest for rate making purposes since its organization as a public utility. Without the power of eminent domain it would long since have been denied access to many of its most valuable leaseholds, and without franchise rights in West Virginia cities and towns it could not have enjoyed the profits of its industry. It can not have two characters in precisely the same activities of its business.

> Ritz, Judge: "For the purpose of this delivery the petitioner under our law is a public servant. It exercises the power of eminent domain for the purpose of securing rights-of-way for its pipe lines. It extends the same over the public highways and streets, and appropriates them to its uses, as it contends, partly for the public good, but partly purely for private ends. The duty of the petitioner to supply the public with gas is its paramount duty. It makes no difference who that public is, or to what use the gas is to be appropriated. If the petitioner was allowed to conduct one-half of its business under public regulation, and to sell the other half of its product upon private contract, the result would be disastrous to the public for the rates charged to private consumers would control those charged to the public consumers, or vice versa. The intricate accounts which would have to be kept in order to indicate the proper part of the company's expenses chargeable to the one or the other part of its business would be so easily manipulated that in the end the so-called private consumers would either be paying largely for the public service or the public consumer would in a large measure be paying for the gas furnished for manufacturing purposes. No

one can serve two masters is as true today as it was two thousand years ago, and it cannot be doubted that, if this petitioner is allowed to divide its allegiance in the manner desired, the service rendered by it to the class of its patrons, which it would soon despise would be inefficient and ineffective to meet their reasonable demands, to the end that the needs of that other class of patrons which had secured its favor might be the more efficiently met. We are clearly of the opinion that so long as the petitioner is engaged in supplying gas to the public in the manner in which it is at this time it cannot supply a part of that public under private contract, and a part of it under public regulation."

Clarksburg Light & Heat Co. v. Public Service Commission, 84 W. Va. 638.

Accord: *Arkansas Nat. Gas Co. v. Norton Co.*, (Ark. Com.) P. U. R. 1924 E 675.

Peoples Gas Co. v. P. S. C. (Pa. Sup. Ct.) 123 Atl. 799, P. U. R. 1924 D 507.

Plaintiff would have this court consider its West Virginia retail business as a separate industry. It makes no suggestion, however, that any adjustment be made for the disproportionate amortization burden which the tremendous sale of gas at inadequate rates to its parent companies necessarily entails.

As shown, the determination of the proper adjustment on the basis of retail sales involves the calculation of the cost of distribution, which Mr. Jirgal fixed at 4.5 cents per M cubic feet. Therefore, it is proper to take issue here before closing the argument on this point, with plaintiff's statement in its bill (R. 19) that "The experts on both sides" agree that the cost of distribution (exclusive of transmission and production cost) to West Virginia domestic consumers is 7 cents per thousand cubic feet. By a most painstaking consideration of all of the elements

of this cost Mr. Jirgal arrived at a figure of 4.5 cents. The basis of this adjustment is fully covered at page 1065 of the Record. The details of this calculation follow:

West Virginia Distribution System Operating Expense (R. 1067)	$101,228.00
Commercial Expenses incurred in West Virginia Retal Business	86,315.00
Fixed Charges on Cost of Reproduction less depreciation—West Virginia Distribution System—found by plaintiff's witness to be $2,380,622 (R. 538)—Taken at 14.6% (13.27% for amortization and return and 1.3% present rate for taxes)	350,400.00
TOTAL	$537,943.00
Number of M Cubic Feet sold in West Virginia in 1923	11,675,645
Average Distribution Cost per M Cubic Feet on above basis	4.6 cents

Instead of seven cents per M cubic feet for cost of distribution, therefore, the highest claim which the protestants recognize would be 4.6 cents per M cubic feet. This cost of distribution is substantially equivalent to the cost which would obtain even if the valuation of plaintiff's engineer were used as a basis. No such cost as seven cents per M cubic feet for distribution is justified by any evidence.

3.—Proper Allowances for Depreciation and Amortization

Chairman Stathers distinguished between depreciation and amortization, evidently considering that the former should cover the renewals of property which are necessary

from time to time, until the exhaustion of the gas supply, but that amortization should cover return of the full fair value of the property ascertained as of any given valuation date.

The Commission ruled that the depreciation allowance should be computed on the original cost of the property. Chairman Stathers held that the much larger allowance for amortization should be calculated on the fair value. The allowance for depreciation was placed at 1.5% of the original cost of the property, which was equivalent to 1.12% on the fair value of the property (R. 129). The allowance for amortization was set at 4.15% of the fair value of the property. Relating these allowances to the fair value of the property as the basis for calculation, a total of 5.27 per cent is arrived at. Commissioner Divine applied amortization as well as depreciation to the book cost (R. 137).

Plaintiff's bill alleges that the Commission erred in arriving at 4.15% as the reasonable allowance for amortization, charging that in arriving at such percentage the Commission fixed the present depreciable value of plaintiff's property by erroneously deducting from its present value its depreciation reserve based on the depreciation rates allowed by the Commission for the period 1910-1923, inclusive. In other words, the plaintiff takes the position that the Commission had no right to take into consideration the fact that the plaintiff had already charged the consumers as a part of its rates, the sum of $14,028,737 for the purpose of amortizing its property (R. 123). To deny the right of the Commission to take these accumulated amounts into consideration is to contend that it must ignore altogether the amount of the plaintiff's property which had been amortized through the rates received by it in the past, which included specific allowances by the Commission for amortization. The effect of such a rule would be to hold that the Commission could never reduce

or increase an amortization rate, if the history of the amortization reserve accumulated through its former orders showed that such reserve was accumulating too fast or not fast enough. It seems self-evident that amortization being a matter of estimate, the Commission must have the power to change the estimated rate, if it finds the actual fact to be that the plant is being amortized too slowly or too rapidly.

This proposition, however, has very little bearing upon the controlling question involved here. The controlling question is: What value will be amortized by the annual amount allowed by the Commission for depreciation and amortization if it is continuously applied until the expiration of plaintiff's gas supply.

The annual amount actually allowed by Commissioner Stathers through the application of the 5.27% to the fair value of $35,989,969.14 was $1,899,537.00 for amortization and depreciation. For the fourteen and one-half years the plaintiff had averaged $203,463.61 for annual depreciation expense (R. 1281). The calculation of this reserve follows:

Balance on December 31, 1923 of Depreciation and Amortization Reserve allowed by commission in previous rate cases	$14,028,737
Annual allowance of $1,696,074 ($1,899,537 less annual depreciation expense of $203,463 based on average of last 14½ years)	30,529,332
Total fair value which would be amortized	$44,558,069

(A)—FACTORS IMPROPERLY DISREGARDED BY COMMISSION

In fixing this amount for depreciation and amortization as reasonable, the Commission left out of consideration the following (See Hagenah's and Jirgal's testimony, R. 480 and R. 409, respectively):

(1) Salvage value when supply of gas is exhausted and non-depreciable properties.

(2) Interest earnings on the reserve fund.

The above amount of $44,585,069 is higher than any fair value of plaintiff's property found by any court or commission. The conclusion from this is that unless the fair value established by the Commission and the District Court is shown to be inadequate, the allowance for depreciation and amortization must be conceded to be liberal to the plaintiff. The District Court held that it was more than sufficient (R. 1235).

It would not be necessary to pursue this matter further but for the contention that the value set by the Commission was appreciably less than the fair value claimed by the plaintiff. The protestants contend that had the Commission considered the two elements relating to amortization and depreciation above pointed out, the annual allowance for amortization computed on the basis of the present fair value of the property instead of its original cost, would have been sufficient to amortize the entire fair value claimed by the plaintiff.

(1)—SALVAGE VALUE AND NON-DEPRECIABLE ITEMS.

It is very difficult, as stated by the Commission, (R. 125) to ascertain the amount of salvage which will remain in the property after the gas supply is exhausted. We know, however, that this salvage value will be a considerable amount. The distribution systems, valued by Mr.

Uebelacker at $3,349,509.00, can be used for the distribution of artificial gas. The company owns valuable real estate, including its office buildings in the cities of Charleston and Huntington, and other property, the appreciated value of which will not be lost when the natural gas supply is exhausted (R. 538). It is a common practice in the gas fields to reclaim from the wells all of the tubing and casing, which can be sold to other producers of natural gas. The transmission and gathering line pipes of the company are, in a great many instances, on or near the surface of the ground, and are therefore not hard to reclaim when they have served their present purposes. In fact, the company is continually removing such pipe in the field from one well location to another, and finds it advantageous to do so, rather than to buy new pipe. The buildings of the company are strategically located, are of a substantial character and could easily be converted to other uses. Much of the machinery of the company would still be useful, and could be sold to other natural gas companies when plaintiff's supply of gas is gone.

It is inconceivable that the salvage value of the property, computed on the same basis on which the fair value has been established, would be less than $5,000,000.00, and it may be as high as $10,000,000.00. However, the record is silent on any basis for making an estimate of salvage value, and we merely note the large possibilities of this item, as the Commission did in its opinion.

Mr. Hagenah, for the protestants (R. 480), indicates that this salvage value would be considerable, though he does not undertake to fix it.

(2.)—INTEREST ON RESERVE FUND.

Of far greater importance than the matter of salvage value is the fact that the plaintiff will secure the Commission's allowance for depreciation and amortization in installments currently, and that it can either use this reserve in its business, if such business requires the same,

or it can withdraw this fund from the business, if it is not necessary thereto. Plaintiff's records show that the amount of its reserve is less than the amount provided by the Commission's former allowances for amortization. The difference manifestly has been withdrawn.

It is approved practice in rate cases to allow for the interest which accumulates on any amortization reserve fund.

Re Wisconsin Telephone Company (Wis.) P. U. R. 1926B, 628.

Re Southern California Telephone Company (Calif.) P. U. R. 1925C, 627.

Re Coos & Curry Telephone Company (Ore.) P. U. R. 1924E, 344.

Re Coast Valley Gas & Electric Company (Calif.) P. U. R. 1924C, 40.

Re Illinois Commerce Commission vs. *Chicago Telephone Company* (Ill.) P. U. R. 1924A, 213.

Re Northwestern Bell Telephone Company (S. Dak.) P. U. R. 1924E, 274.

Re Great Western Power Company (Calif.) P. U. R.) 1923C, 545.

Re Kootenai Power Company (Idaho) P. U. R. 1923A, 704.

Re Idaho Power Company (Idaho) P. U. R. 1923B, 52.

Re Meade, C. H., Coal Company vs. *Appalachian Power Company* (W. Va.) P. U. R. 1923E, 221, 226.

Re Frankfort Heating Company (Ind. P. S. C.) decided September 10, 1919.

Re Bay City Water Company (Ore. Com.) P. U. R. 1924E, 653.

Re Kootenai Power Company (Idaho) P. U. R. 1923C, 159.

Mr. Hagenah testified that interest should be calculated on the reserve (R. 456, 457 and 458). The West Virginia record, being reduced to narrative form, does not bring out the thought as clearly as does the Kentucky record relating to the same question, where the full transcript of his testimony in this proceeding is copied. Mr. Hagenah's explanation appears at page 936 of the Kentucky record:

> "Now as to the first group of purely depreciation reserve, just as we find that reserve in all other continuing public utilities. There it is for the purpose of making replacements. You cannot make replacements every year on every class of property. Some has a long life and some has a short life. Assuming that the reserve provision is made with every possible care and accuracy, there must always be and will always be, in the strictly depreciation reserve, a credit balance. As to that credit balance which the company is using in its business, or, for that matter, investing in the bank or any other place, the interest which it earns should be credited to depreciation reserve, and to that extent reduce the charge against the public for operating expenses."

Mr. Engal pointed out, in criticism of the company's book allowance, that it did not provide for interest on the accumulated depreciation reserve balance (R. 409).

The importance of this factor is indicated by the following table, which shows that if interest is allowed at the low rates of 4, 5 and 6% annually compounded, the valuation which can be amortized out of the Commission's annual allowance is far in excess of plaintiff's contentions as to the fair value. (18 years used as life of property.)

	Interest calculated at 4% per year	*Interest calculated at 5% per year*	*Interest calculated at 6% per year*
Balance in reserve on December 31, 1923 (14,028,737)	$28,410,509.97	$33,761,827.82	$40,042,772.54
Annual Net Allowance of $1,696,074	43,496,518.21	47,714,606.76	52,418,274.51
Total Fair Value which would be amortized	$71,907,028.18	$81,476,434.58	$92,461,047.05

The District Court took into account the interest which the reserve would earn in reducing the Commission's allowance of 4.15% for amortization to 3.65% (R.1235, 1236).

As already indicated, besides the factors of salvage value and the interest accumulations, the Commission did not consider specifically any of the depreciation reserve accumulations for the period from 1909 to 1916, seven years, and it did not consider specifically that a great many of the minor renewals of the company are charged to maintenance.

The Commission, therefore, in making its depreciation and amortization allowance, used an amount which was far in excess of the amount necessary to amortize the fair value of the property determined by it and, in fact, the amount allowed was more than sufficient to amortize the fair value claimed by the plaintiff.

(B)—DEPRECIATION AND AMORTIZATION SHOULD BE CALCULATED ON COST

Protestants submit that the present fair value of the property is not the proper basis on which the depreciation and amortization should be calculated.

Knoxville v. *Knoxville Water Co.*, 212 U. S. 1, 13.

The reasons for calculating the depreciation and amortization allowance on investment cost are summarized by Jirgal, as follows (R. 401):

(1) The purpose of the depreciation and amortization reserve is to keep the investment intact, and not to return to the investor the cost of reproduction at any given valuation date.

(2) The original cost is the common basis for calculating depreciation and depletion in order to compute profit in all industry (R. 402).

(3) The applicant may use the difference between the allowance for depreciation and amortization computed on fair value and such allowance computed on cost, as additional profit available for dividends, so that the Commission's allowance for these items on this basis is in effect giving the company an additional return over and above the eight per cent found by it as reasonable (R. 402).

(4) The classification of accounts adopted by Public Service Commissions generally, and by the West Virginia Public Service Commission for natural gas companies, provides that depreciation shall be calculated on original cost. The following is an extract from the West Virginia classification relating to natural gas companies:

> "In determining its rate of depreciation the utility shall, in the case of those structures and items of equipment that can be satisfactorily individualized, provide for each such structure and item

of equipment an amount which will through regular accumulation insure at the time such structure or item of equipment goes out of service a reserve therefor equal to the *original money cost* thereof less salvage recovered thereon. In the case of those structures and items of equipment that cannot be satisfactorily individualized the utility shall keep such structures and equipment in efficient condition through repairs and shall treat all renewals or replacements of parts thereof as repairs." * * * and,

"Credit to this account and charge to Amortization of franchises, patent rights and licenses accounts those amounts which, through regular application, will provide at the expiration of the lives of the utility's limited franchises, patent rights and licenses, limited rights of way, and *leaseholds*, a reserve equal to their *original money cost*." (R. 402-3.)

(5) The company loses nothing by this method of calculating depreciation and amortization, because the difference between the original cost of property retired from service and the cost of the property by which it is replaced, is added to its capital account. (R. 403.)

(6) Public utility mortgages commonly provide for this basis of withdrawing additional bonds from time to time. (R. 403.)

(7) To compute depreciation on any other basis than original cost results in a fluctuating basis for computation which cannot be used practically by the company in its records every time the price level changes. (R. 404.)

Mr. Hagenah takes the same view with respect to the basis for calculating depreciation. He points out that the purpose of the reserve is to maintain intact the integrity of the investment, and, further, to protect the investor in

the actual cost of the property he has devoted to the public use. He further states that the utility is not to be protected on any such speculative basis as is brought about by changes in the price level. He brings out very forcibly that the reserve cannot be applied on any uncertain or fluctuating principle, and that appreciation should not be retired through a depreciation reserve which is, in effect, what is done if cost of reproduction is used as a basis for calculating depreciation and amortization allowances.

The protestants, therefore, submit that the Commission's allowance for depreciation and amortization is excessive and unreasonable; that it is more than is required to keep the investment of the plaintiff intact; that instead of allowing $1,899,537, it should have allowed not in excess of $1,399,227 (5.3% of book cost R. 1161). This appears as follows:

Balance at December 31, 1923 of Depreciation and Amortization Reserve allowed by Commission in previous rate cases	$14,028,737
Annual Allowance of $1,195,764 ($1,399,227 less annual expenses of $203,463 based on average of last 14½ years)	21,523,752
Total investment which would be amortized	$35,552,489

The book cost of the entire property as of December 31, 1923, was only $26,288,912 (R. 1067) including both depreciable and non-depreciable property, so that the above allowance is more than ample. Retirements of property since 1909 were only $2,950,222.32 (R. 1145).

If interest at 4, 5 and 6% is computed on these items, as we did upon the allowances made by the Commission (ante) there results an amount in excess of any value of plaintiff's property reasonably supported by the evidence, appears from the following table:

	Interest Calculated at 4% per Year	*Interest Calculated at 5% per Year*	*Interest Calculated at 6% per Year*
Balance in Reserve December 31, 1923 ($14,028,737)	$28,410,569.97	$33,761,827.82	$40,042,772.54
Annual net allowance of $1,195,764	30,665,861.63	33,639,693.22	36,955,867.25
Total Fair Value which would be amortized	$59,076,371.60	$67,401,521.04	$76,998,639.79

Commissioner Divine (R. 137), held that depreciation and amortization should be based on cost. Judge Hickenlooper held that that part of the allowance which represents amortization (termed by him "depletion"), should be computed on "investment value".

This question has been before the Commissions of many of the states. While some (frequently because of the absence of proof of original cost) hold with Chairman Stathers that amortization should be computed upon fair value, we believe that the majority are in accord with Judge Hickenlooper and Commissioner Divine that investment cost is the true basis for calculation. Among

the many cases so holding, the following are representative:

Re Cumberland & Allegheny Gas Co., decided by W. Va. P. S. Com. Oct. 27, 1927.

Re Georgia Ry. & P. Co. v. Ry. Com. (U. S. D. C.) P. U. R. 1925A 546, 593.

Re Springfield Gas & Electric Co. (Ill.) P. U. R. 1919 B 746;

Re Southern Pacific Co. (Nev.) P. U. R. 1920 F 725, 769;

Re Coast Gas Company, (N. J.) P. U. R. 1923 A 349;

Re Public Service Railway Co., (N. J.) P. U. R. 1921 D 953;

Re Bronx Gas & Electric Co. v. P. S. C., (N. Y. Sup. Ct.) P. U. R. 1923 A 255;

Re Wisconsin-Minnesota Light & Power Co., (Wis.) P. U. R. 1920 D 428;

Re Philippine Ship Owners' Assn., (P. I.) P. U. R. 1921 C 536;

Re Champaign & Urbana Water Co., (Ill.) P. U. R. 1919 E 798;

Re St. Joseph Water Co. (Mo.) P. U. R. 1924 B 338;

Re Baird v. Burleson, (N. Y., 2nd Dist.) P. U. R. 1920 D 529;

Re LaPorte Gas & Electric Co., (Ind.) P. U. R. 1921 A 824

Re Commonwealth v. Newport News L. & W. Co. (Va.) P. U. R. 1923D 91.

Protestants claim that the original cost is the only basis which will equitably spread over the life of the property the total amount to be depreciated or amortized by equalizing the annual allowances, and that an annual allowance of $1,399,227 is more than sufficient to keep the investment intact. In fact it is more than sufficient to

return to the plaintiff any fair value which may reasonably be found from the evidence in this case.

The Court can hardly take seriously plaintiff's contention (Brief, p. 55), that the Commission provided for the retirement of but $20,981,252 worth of property. The amount allowed by it, $1,809,537, is $500,000 in excess of what it would have been had the percentage (5.27) been applied to the book cost.

4.—The Propriety of Including Lease Rentals and Lease Expenses in Operating Costs.

The delay rentals and leasehold expenses expended in the year 1923 to preserve plaintiff's gas leases amounted to $589,186 (R. 1276). This amount was included in the operating expenses for that year and deducted from earnings. The question as to the propriety of including these items in operating expenses has been referred to in another part of this brief. It has been noted already that the only basis on which confiscation can be claimed in this case is on the theory that the full value of the gas rights contended for by the plaintiff should have been allowed by the commission. It will appear later that there was practically no dispute before the Commission as to the value of the physical property, the going concern value, or the working capital. If the entire amount of appreciation in the gas rights claimed by the plaintiff is necessary in order to prove confiscation, and it be assumed for the present that it is entitled to such full appreciation, then we submit it cannot equitably include in the operating expenses any item which is in the nature of a carrying charge on the element of property for which such full appreciation is claimed. To allow the items of delay rentals and leasehold expense to remain in the operating expenses is to charge the consumers for the full appreciation in plaintiff's property, and in addition to

assess them with the cost of acquiring and holding the property. Plaintiff occupies the anomalous position of one who, after contracting to sell property to another and collecting part of the purchase price from the purchaser in possession, attempts to continue to collect rent for the same property as if it were still his own.

If the consumers pay the carrying charges in addition to bearing the depreciation, amortization and fair return, they are not only paying a fair return on the appreciated value but are also permitting the plaintiff to charge them with the cost of the appreciation.

The protestants, in their exhibits before the Commission, did not deduct rentals and carrying charges for the reason that they claimed that the book cost of the leaseholds, and not their appreciated value, should be taken as the fair value thereof. However, upon the argument in the District Court, they presented two exhibits, "Jirgal Exhibit 3 J C No 1" (R. 1161), and "Jirgal Exhibit 3 J C No 2" (R. 1162), which showed the net earnings before deducting leasehold rentals.

The District Court noted that the statements contained in its opinion relative to the net earnings available for return and amortization were subject to the reservation as to the right of the plaintiff to include in operating expenses "the payment of delayed rentals to preserve its leases or options in unoperated territory." (R. 1271.)

Protestants submit that it appears that the net earnings of the plaintiff from its property as a whole available for return on investment is not less than the amount shown by the protestants' witness Jirgal, in "Jirgal Exhibit 3 J C No 1" (R. 1161) or $5,694,229. This amount, when capitalized at 8%, gives a value of $71,177,000. There has been shown (ante p. 91) the effective valuations arrived at by a capitalization of the earnings which result from the rates approved by each of the Commissioners and the District Court as compared with the value which they found by considering the various elements of

physical and intangible property. For convenience this comparison is tabulated at this point showing the result of excluding delay rentals from operating expenses for reasons above disclosed:

	Value arrived at by Capitalizing Earnings on Percentages found Reasonable for Return or for Return Depreciation and Amortization	*Fair Value Determined*
Public Service Commission of West Virginia:		
1 By Chairman Stathers:		
(a) On Basis of including delay rentals in operating expenses	$67,000,000.00*	$35,999,969.14
(b) On Basis of excluding delay rentals from operating expenses	74,300,000.00*	35,999,969.14
2 By Commissioner Divine:		
(a) On Basis of including delay rentals in operating expenses	65,000,000.00*	40,165,000.00
(b) On Basis of excluding delay rentals from operating expenses	72,300,000.00*	41,165,000.00
District Court for Southern District of West Virginia:		
3 On Basis of Adjusting Parent Company rates to comparable wholesale rates	58,858,872.27**	40,307,311.39
4 On Basis of Adjusting Parent Company rates to rates comparable with those applying to West Virginia retail consumers	53,295,228.84**	40,307,311.39

5. Same as 3 except delay rentals as deducted from operating expenses	67,900,000.00***	40,307,311.39
6. Same as 4 except delay rentals are deducted from operating expenses	58,308,000.00***	40,308,311.39

*Arrived at by capitalizing net earnings at 8%.

**See Judge Rose's Opinion R. 1239.

***Approximately $5,000,000 added—See Judge Rose's Opinion R. 1271 and 1272.

In conclusion upon this point, we respectfully submit that regardless of the merits of the plaintiff's criticism as to the valuation of the different classes and items of its property by the Commission, both physical and leaseholds, the net earnings from this property allowed by the Commission when capitalized on a reasonable and proper basis produce a capital value approximately equal to that claimed by the plaintiff and in excess of any value of its property that can be predicated upon the record in this suit. If this be true, there is no confiscation.

VI.—REASONABLE RETURN

Plaintiff does not deny the reasonableness of the return of 8% allowed by the Commission. (R. 130.) Eight per cent or less has been approved in many natural gas cases.

Columbus Gas Co. v. Columbus, 17 Fed. (2d) 630, P. U. R. 1927 C. 639 ..... 7.07%

Re Jackson County Light, Heat & Power Co. (Mo.) P. U. R. 1926 D. 737 ..... 8%

Re Crystal City Gas Co. (N. Y. P. S. C.) P. U. R. 1925 E. 91 ..... 8%

Village of Antioch v. Boyles (Ohio P. U. C.) P. U. R. 1925 E. 152 ..... 8%

Re Peoples Natural Gas Company, (P. S. C. N. Y.) P. U. R. 1916 A 349 8%

Amhurst v. Snyder Gas Company, (N. Y. P. S. C.) P. U. R. 1921 D 539 8%

Re Fuel Gas Company, (Ind. P. S. C.) P. U. R. 1919 C 879 7%

Re Indiana Gas Light Company, (Ind. P. S. C.) P. U. R. 1921 E 441 7%

Re Rockford Gas Light & Coke Co., (Ill.) P. U. R. 1920 E 641 7.3%

Re Monarch Gas Company, (Ind. P. S. C.) P. U. R. 1920 C 960 7%

Re Sheridan Gas, Oil & Coal Co., (Ind. P. S. C.) P. U. R. 1921 E 7%

Re Richmond Light, Heat & Power Co., (Ind. P. S. C.) P. U. R. 1917 B 300 7%

Okmulgee Gas Co. v. Corp. Com. (Okla. Sup. Ct.) 220 Pac. 28 8%

Municipal Gas Co. v. Wichita Falls (Tex. R. R. Com.) P. U. R. 1924 B 410 8%

Billings v. Billings Gas Co. (Mont. P. S. C.) P. U. R. 1924 C 217 6.1%

Consumers' Gas Co. v. Corporation Com., (Okla. Sup. Ct.) 219 P. 126 8%

Re Billings Gas Company, (Mont.) P. U. R. 1925 B 363 8%

Oklahoma Nat. Gas Co. v. Corp. Com., (Okla. S. C.) 216 P. 917 8%

Landon v. Public Utility Com., 234 Fed. 152, P. U. R. 1917 A 120 8%

Re Utility Gas Co., (W. Va.) P. U. R. 1726 A 57 8%

Re Point Pleasant Natural Gas Co., (W. Va.) 1927 B 805 8%

VII.

THE FAIR VALUE OF PLAINTIFF'S PROPERTY

1.—Physical Property

The findings of the value of the physical property, that is, the property exclusive of gas rights, working capital and going concern value, in this case were as follows:

By the Commission	
Commissioner Stathers	$25,000,000.00
Commissioner Divine	26,000,000.00
By the Courts	
Judge Rose	26,000,000.00
Judge Hickenlooper	26,283,844.00

The evidence before the Commission and the Courts on this point included the cost of reproduction new as estimated by plaintiff's witness Uebelacker and protestants' witness Hagenah, the cost of reproduction new less accrued depreciation also estimated by these two witnesses, the estimated historical cost submitted by Mr. Uebelacker for the plaintiff, and the actual book cost of the property as determined from the plaintiff's books by Mr. Jirgal for the protestants.

Upon the hearing in the District Court Mr. Hagenah submitted an estimate of the cost of reproduction new, arrived at by the application of the index numbers of the United States Bureau of Labor to the actual book cost. (R. 484-486.)

(A)—COST OF REPRODUCTION NEW OF PHYSICAL PROPERTY

As stated, an estimate of the cost of reproduction new (undepreciated) was submitted by Mr. Uebelacker, which, except as to overheads, was accepted by Mr. Hagenah. Their estimates of the value of the several items of plaintiff's property, including overheads, are shown below:

	As found by Mr. Uebelacker (R. 537-538)	*As found by Mr. Hagenah* (R. 1166-1168)	*Difference*
Production System Exclusive of Leaseholds	$12,574,788.00	$12,575,511.00	$ 723.00
Transmission System	13,467,823.00	13,468,485.00	662.00
Distribution System	3,269,363.00	3,269,366.00	3.00
General Property	679,140.00	679,140.00	
TOTAL	$29,991,114.00	$29,992,502.00	$ 1,388.00
General Overhead Charges	7,063,311.00	5,398,650.00*	1,664,661.00
Total Reproduction Cost Exclusive of Leaseholds	$37,054,425.00	$35,391,152.00	$1,663,273.00

*18% of physical property. (R. 428.)

See "Uebelacker Exhibit No. 1" (R. 536) and "Hagenah Exhibit No. 1" (R. 1163).

The Commission properly found that there was no difference between the plaintiff and protestants in the matter of the reproduction cost new, exclusive of overheads.

(B)—COST OF REPRODUCTION NEW LESS DEPRECIATION

Both Mr. Uebelacker and Mr. Hagenah, after estimating the cost of reproducion of the physical property, proceeded to estimate the amount of accrued depreciation in the same, and as a result of a study of the property they concluded that such cost of reproduction new less accrued depreciation as of December 31, 1923, was as follows:

	As found by Mr. Uebelacker (R. 537-538)	*As found by Mr. Hagenah* (R. 1166-1168)	*Difference*
Production System (Exclusive of Leaseholds)	$ 7,830,400.00	$ 7,389,894.00	**$ 440,506.00**
Transmission System	11,154,326.00	9,713,397.00	**1,440,929.00**
Distribution System	2,694,806.00	2,633,268.00	**61,538.00**
General Property	594,742.00	576,305.00	**18,437.00**
Total Specific Cost	22,274,274.00	$20,312,864.00	**$1,961,410.00**
General Overhead Charges (depreciated)	6,357,046.00	3,656,316.00	**2,700,730.00**
Total Reproduction Cost less Depreciation (Exclusive of Leaseholds)	$28,631,320	$23,969,180.00	**$4,662,140.00**

It will be noted that in the case of these two estimates there is again a decided difference as to the amount of overhead expense which should be applied to the specific cost of construction, and that in addition there is a very material difference in the estimates of the two engineers as to the amount which should be deducted for accrued depreciation.

These items will be taken up in order.

(1)—OVERHEAD CHARGES:

Mr. Uebelacker not only included considerable percentages for direct overheads, but also included excessive amounts for general overheads. The direct overheads testified by him as having been included (R. 517) were as follows:

Liability insurance	1%
Loss and use of tools	1½% to 2%
Field supervision	½% to 8%
Time keeping	1%, and
Contingencies	2% to 5%

The general overheads included by him are given below:

	Production System	*Transmission System*	*Distribution System*	*General Property*
Engineering and Superintendence	2½%	7%	3%	3%
Administration	2	2	2	2
Interest (during construction)	8	8	8	8
Preconstruction Costs	2½	2½	2½	2½
Legal Expenses	1½	1½	1½	1½
Insurance and taxes	1	1	1	1
Cost of Financing	4	4	4	1
	21½%	26%	22%	22%

The Commission approved Uebelacker's calculations of the overheads:

> "If there was any doubt as to what Mr. Uebelacker meant by 'cost of financing' after he first testified in this case, that doubt was removed by him in 'Uebelacker Exhibit No. A', as was also the

matter of interest during construction. Further, other testimony in the record sustains Mr. Uebelacker in his figures as to cost of financing and interest during construction, both of which are allowed and considered by the Commission in connection with Mr. Uebelacker's estimate of reproduction cost new in this property."

(Opinion of Commission, R. 88.)

Mr. Hagenah allowed for overheads $5,398,650 (undepreciated), being 18% of the physical property.

The protestants insist that this overhead item, when properly depreciated as done by Mr. Hagenah, is not in excess of $3,656,310. As previously stated, the difference between the witnesses as to overheads rests upon two items, cost of financing and interest during construction.

(a)—*Cost of Financing.*

Mr. Uebelacker allows 4% for cost of financing, which he defines as follows:

"The cost of financing includes the expense involved in assembling the necessary capital for the enterprise and must not be confused with bond discount which has not been considered in the estimates. This expense is that which would be incurred in the floating of securities and as the interest rate provides for the current market return upon the investment there is no discount to be considered."

(Uebelacker Ex. No. 1, R. 519.)

Mr. Hagenah, on the other hand, (R. 475) rejects the item of financing cost as a capital charge on the ground that such an expense "should be distributed over the period for which the financing was incurred." Illustrating his position, he says that if some one is hired to sell the securi-

ties, or because of their reduced interest rate they are sold at less than par, such additional cost of money should be amortized over the life of the securities, whether the cost be in the nature of discount, or as Mr. Uebelacker contends, merely sales cost.

In short, Mr. Hagenah makes the same answer to Mr. Uebelacker's attempted distinction between the expense of assembling capital and bond discount as the New Jersey Board of Public Utility Commissioners made to similar testimony offered by Ford, Bacon and Davis, of which firm Mr. Uebelacker is a member:

> "Discounts on bonds and commissions are always very closely allied. Generally speaking, the system of accounts adopted by this board does not distinguish between the two charges but provides that all discounts and commissions shall be excluded from the capital account and amortized out of the earnings over a term of years. In other words, bond discount and commissions are regarded as another form of interest rates.
>
> "The board finds and determines that all amounts claimed for commissions and discounts in the sale of securities should be excluded in determining fair value and further finds that due consideration will be given to these claims in determining the fair rate of return."
>
> *Re Public Service Ry Co.*, P U R 1921 D 593

On the same subject the Supreme Court of Appeals of West Virginia said:

> "One item of $193,782.85 for financing improvements and betterments, shown on page 10 of Jirgal's Exhibit No. 1, and deducted by him from the total

of the book cost of the gas property, appears to represent discount and expenses on the sale of the company's securities, certain bonds sold in August, 1921. This deduction was proper. All the authorities seem to agree that discount on securities is not a proper charge to capital but is simply an adjustment of interest. *1 Whitten on Pub. Ser. Corp.*, Sec. 322, p. 273. The discount should be amortized during the life of the securities."

Charleston v. Public Service Commission, 95 W. Va. 91, 130, 120 S. E. 398.

Call it "bond discount" or the "expense of the sale of the securities" or, as Mr. Uebelacker says, "the expense involved in assembling the necessary capital", the thing itself is the same, viz., an expenditure which reduces the net amount realized from the securities of the enterprise, differing in no sense from the interest charges, as explained by Jirgal:

"In no company's books is that (cost of financing) accounted for as construction costs, that is accounted for as nothing more than bond discount and expense, what is covered if the company puts in anything and what it puts in at the total discount. That is, the difference between par value and the amount which it gets from its securities."

(Jirgal, R. 407.)

The question seems to us to have been definitely disposed of by this court in the Galveston case as follows:

"The other item included by the master in determining base value, but disallowed by the court, is $67,078 for brokerage fees. There is no evidence that any sum was in fact paid as brokerage, and there was included, as above shown, the sum of $73,281 for organization and business management

in calculating the historical reproduction cost. The finding of the master rests upon testimony that bankers customarily get, in some form, compensation equal to 4 per cent on the money procured by them for such enterprises. But compensation for broker's services is often paid in the lessened price at which they take the company's securities, and is thus represented in the higher rate of interest or dividend paid on the money actually received by the company as capital. The reason given by the master for including the allowance for an assumed brokerage fee is that a brokerage fee is a 'normal incident of large industrial investments and has not been amortized', since 'the record shows that the plant has been operated at a loss'. If base value were to be fixed by the money expended, brokerage fees actually paid might with propriety, be included, as are taxes paid pending construction. But as the base value considered is the present value, that value must be measured by money, and the customary cost of obtaining the money is immaterial. We cannot say that the court erred in refusing to include in base value an allowance for hypothetical brokers' fees."

Galveston Electric Co. v. *Galveston*, 258 U. S. 388, 66 L. Ed. 678, 42 Sup. Ct. 486.

See Vol. I, Spurr, Guiding Principles of Public Utility Regulation, pp. 468-469.

Colo. Power Co. v. *Halderman*, 295 Fed. 178.

In their brief below counsel for plaintiff said that to Mr. Uebelacker "cost of financing" means the cost to be paid to a reputable broker "for inducing his clientage to invest in the securities', an estimated and speculative brokerage fee, precisely the thing condemned by this court, in the opinion of Mr. Justice Brandeis. As against

the decision of this court plaintiff in its brief filed here cites two commission cases from Utah. (Appellant's brief, p. 42.)

(b)—*Interest During Construction*

Counsel for plaintiff argue that Mr. Hagenah's opinion that 7% is a sufficient allowance is not based upon any "personal experience in the construction of a plant like plaintiff's." (Brief, p. 42.) On the other hand, it is claimed that Uebelacker's testimony that 8% should be allowed is based not upon opinion but upon actual experience in the construction of a similar plant. We challenge the statement that Uebelacker's dictum, based largely on his experience in the construction of a single plant in northern Alberta, Canada, is controlling in this matter. (R. 205.)

Mr. Hagenah testifies that this company, with the enormous quantities of gas and the vast business available to it, "could finance itself on a year to year basis with 7 per cent money", that it could do this while building its plant, adding its consumers as its transmission lines are extended from city to city. As to many classes of property, the construction period would not exceed six months, and whether the company is assumed to borrow its construction funds at 6 per cent, 7 per cent, or at 8 per cent, an allowance of 7 per cent on the entire property is most liberal. (R. 476.)

Experience the country over, as reflected by the estimates approved by courts and commissions, uniformly supports the conclusion that an allowance of 7 per cent to cover the cost of interest during construction is indeed liberal.

> "In valuing the plant for purposes of arriving at a rate base, a charge for interest upon capital during construction is proper. *Ohio Utilities Co. v. Public Service Commission*, 267 U. S. 359, 45 Sup. Ct. 259, 69 L. Ed. 656. It is also true that in some natural gas projects the highly speculative

nature of the investment would necessitate high interest rates. But in determining what rate of interest should be applied in any specific case the nature of the business involved must be considered. Here the element of speculation is reduced to a minimum. The properties are proved and producing, and were so when the company was organized. The markets are established. The company is the subsidiary of two other large, substantial, successful corporations. There are not and never were, any of the elements of the speculative, 'wildcat' venture. **We are of the opinion that the 7 per cent interest rate conceded by the witness Hagenah, for the protesting municipalities, is sufficient, even generous.**"

United Fuel Gas Company v. R. R. Com. of Ky. 13 Fed. (2d.), 510, 520.

In the following cases allowances for interest during construction ranging from three to seven per cent were approved:

State Journal Prtg. Co. v. Madison G. & El. Co., 4 Wis. R. C. 501.

Re Mountain States Tel. & Tel. Co., (Colo.) P. U. R. 1917 B 198.

Re Mountain States Tel. & Tel. Co., (Idaho), P. U. R. 1921 B 738.

Columbia v. Watts Eng. Co., (Mo.) P. U. R. 1915 B 921.

Re Petaluma & S. R. R. (Cal.) P. U. R. 1915 B 742.

Re San Francisco-Oakland Term. Ry. (Cal.) P. U. R. 1915 D 44.

Metropolitan Trust Co. v. Houston & T. C. R. Co., 90 Fed. 683.

Re Public Service R Co (N J) P U R 1921 D 593

Among the many cases cited by Spurr in his chapter on blanket overhead allowances there is but one which permits more than 20% for such charges (Vol 1, pp 426-443) It involved the construction of a hydro-electric plant where the California Commission allowed 23½% for three year construction, *the unit costs not having included any item for contingencies or omissions or for engineering and superintendence*

There is, of course, no occasion in the present case to make provision for any such omission in the unit cost estimates, as will clearly appear from Mr Uebelacker's testimony

> "In building up unit prices for the installation of pipe lines, compression stations, meters, and, in fact, in the acquisition of all materials, an allowance was made to cover certain direct overheads which are part of the direct cost of the property in place
>
> "Based upon labor in all installations, an allowance was made for liability insurance at 1 per cent, loss and use of tools from 1½ to 2 per cent, field supervision from ½ to 1 per cent in the case of miscellaneous structures to 8 per cent in the installation of compressing station equipment, timekeeping at 1 per cent on pipe lines and miscellaneous structures, and contingencies from 2 per cent in the case of compressing stations and the smaller miscellaneous accounts to 4 and 5 per cent in the case of gathering, transmission and distribution lines

"On materials, those direct overheads are ½ of 1 per cent for purchasing, from ½ to 4 per cent for warehouse handling and from 2 to 5 per cent for contingencies.

"A fee or contractor's profit of 10 per cent was allowed on the cost of all buildings and structures. The contingencies cover unforseen costs in construction and such other costs as are not apparent in completed construction.

"These percentage allowances were determined from a study of the records of the Company in actual installations and from similar experience of other companies."

("Uebelacker Exhibit No. 1", R. 516-517.)

All of these direct overhead costs were included by Mr. Uebelacker in addition to the general overhead charges which are here attacked.

In two instances the Maryland Commission allowed 19.9 per cent and 17.67 per cent in a water rate and telephone rate case, respectively. In one case the New York Commission allowed 20 per cent representing "actual labor and material costs." *Davis v. Penna Gas Co.*, P. U. R. 1921 B 342, and in another a similar allowance for engineering, supervision and contingencies where the record failed to show the amount expended. *Re Bronx Gas & E. Co.*, P. U. R. 1916 A 440. Showing the trend of judicial thought, we append the following list of commission decisions, showing allowances for overheads.

15 Per Cent Allowed for Overheads

Re Penobscot Water Co., (Me.) P. U. R. 1923 B 771.

Re Lansing Fuel & Gas Co., (Mich.) P. U. R. 1921 D 387.

Re United Railways Co. (Mo.) P. U. R. 1923 D 759.

Re Trenton Gas & Elec. Co. (Mo.) P. U. R. 1923 D 314.

Re Platte County Tel. Co. (Neb.) P. U. R. 1922 D 303.

Mantau Tship. v. New Jersey Gas Co. (N. J.) P. U. R. 1916 C 163.

Belott v. Belott Water & Gas Co. (Wis.) P. U. R. 1915 B 1005.

14 Per Cent

Re Portland E. L. & Power Co. (Ore.) P. U. R. 1916 D 976.

13.5 Per Cent

Petersburg Gas Co. v. Petersburg (Va.) P. U. R. 1923 B 259.

13 Per Cent

Re Moundsville Water Co. (W. Va.) P. U. R. 1922 B 28.

Re Grand Rapids (Mich.) P. U. R. 1923 C 453.

Westminster v. Pub. Util. Co. (Md.) P. U. R. 1919 E 508.

Re Springfield Gas & Electric Co. (Ill.) P. U. R. 1920 A 446.

Peck v. Indianapolis L. & H. Co. (Ind.) P. U. R. 1916 B 445.

12 Per Cent

Re Capital City Water Co. (Mo.) P. U. R. 1918 D 561.

Fargo v. Union L. H. & P. Co. (N. D.) P. U. R. 1920 A 764.

Illinois Commerce Commission v. *Chicago Tel. Co.*, (Ill.) P. U. R. 1924 A 213;
Patterson v. *Hughes Electric Co.*, (N. D.) P. U. R. 1921 A 1
Commercial Club v. *Citizens Gas & Fuel Co.*, (Ind.) P. U. R. 1916 E 1
Re Falls Light & Power Co., (Wis.) P. U. R. 1916 D 151

10 Per Cent

Dunn v. *Rutland E. L. & P. Co.*, (Ut.) P. U. R. 1923 C 316

We conclude our discussion of overheads with a reference to Judge Rose's views upon the allowance made by Mr. Uebelacker. (R. 1241.)

Judge Rose first referred to the reproduction cost new of plaintiff's physical property not including going value or working capital, estimated by Mr. Uebelacker at $37,054,425. He then took the book cost of the same property and with the index figures of the Department of Labor, translated that book cost into dollars of the year 1923, and set the amount so found, $24,546,309, against the reproduction estimates of the plaintiff. Allowing liberally for the possibility that such materials as went into plaintiff's plant increased in cost at a higher rate than has the average of all commodities, he found that the difference between the actual cost of the plaintiff's plant in dollars of 1923 and the amount its expert witnesses say would be required to reproduce it, is no less than $8,000,000. He then pertinently inquires whence comes this difference.

"We are persuaded that it is almost altogether due to the liberality with which the witnesses estimate the outlay which in reproduction would be

made for direct and general overheads. The latter alone are figured at $7,063,311. There is no possible question that in almost all of these rate cases the overhead charges included in the estimated cost of reproduction greatly exceed any sum that the utility actually paid out for such purposes. A large and widely distributed plant is ordinarily a growth extending over many years. Its property is managed by its officers and its construction is financed in installments. The large overheads estimated by the experts are simply not incurred. The plaintiff's expert based his calculation concerning them largely upon the experience he had in the erection of other plants, especially one in Alberta, Canada. He apparently ignored the history of the construction of the plaintiff about which he was testifying, *for it is certain that no such expenditures for overheads were in fact found necessary by it.* The writer of this opinion had on another occasion to give some consideration to the great discrepancy there almost always is between what the experts, in making up a reproduction cost estimate must be expended for overhead and the sums the particular utility actually laid out for such purposes. *Chesapeake & Potomac Telephone Co. of Baltimore City* vs. *Whitman*, 3 Fed. (2d) 938, 967, et seq.

(R. 1242; 14 Fed. (2d) 209, 214.)

(2)—ALLOWANCE FOR ACCRUED DEPRECIATION.

Mr. Uebelacker and Mr. Hagenah agree that accrued depreciation should be deducted from the reproduction cost new of the physical property, including the allowance for overheads. They differ as to the theories of calculating such depreciation. The Commission has this to say of their positions:

"As indicated herein, in arriving at the reproduction cost of the physical property, less depreci

> tion. Mr. Uebelacker reaches the extent or amount of deterioration or depreciation through what is called the 'observed depreciation method'. Mr. Hagenah (Hagenah Ex. No. 1) disapproves of this method and in its place offers a combination of 'the observed depreciation method' and 'the amortization rule', explaining on page three of said exhibit in the following language: 'In all cases where the normal life of the property will be cut short by the exhaustion of the gas reserves, the present condition has been ascertained by the application of the amortization rule; but in all other respects the facts as found by Ford, Bacon and Davis have been accepted'." (R. 87.)

It then proceeded to adopt in full the findings of Mr. Uebelacker, rejecting the "theoretical" and "speculative" procedure of Mr. Hagenah.

With the exception of items comprising the "Gas well construction" acount, with reference to which "it was taken as a reasonable assumption that the wells were in a condition of depletion as was indicated by the decline in rock pressure" (R. 510), Mr. Uebelacker employed the observation or inspection method throughout. That is, he made no deduction for depreciation other than that which was apparent to him from the physical condition of the property at the time of his inspection.

Mr. Hagenah defines his plan clearly and concisely in his Exhibit No. 1 (R. 1164-1165), introducing his explanation as follows:

> "Obviously, the useful life of a large part of the company's property is limited to the life of the natural gas fields, which latter period the engineers have found to be approximately 18 years. The per cent condition of the property was determined by the above engineers (Ford, Bacon & Davis) from an inspection of the physical property, in

which consideration was apparently given only to its physical condition as of the inventory date. This method ignores the limitation on the use of the property which the life of the field imposes, with the result that since the investment must be amortized over the life of such field, the present worth of the property affected thereby should be determined with regard to such diminishing value, especially when such loss in worth is being met through operating charges. *Because of this fact the ordinary rules for determining the measure of depreciation by inspection do not apply.*"

His view is sustained by a number of authorities, including

Okmulgee Gas Co. v. Corp. Com. (Okla. Sup. Ct.) 220 Pac. 28.

Re Associated Telephone Co. (Ind. P. S. C.) P. U. R. 1927 C 577.

Columbus Gas & Fuel Co. v. Columbus, 17 Fed. (2d) 630.

Chesapeake & Potomac Tel. Co. v. Virginia (Va. Sup. Ct.) P. U. R. 1927 B 484.

Re Missouri Union Tel. Co. (Mo. P. S. C.) P. U. R. 1926 A 842.

Re Plainfield Union Water Co. (N. J. Board) P. U. R. 1924 D 480.

Mr. Hagenah divided the property into two classes: that class of property which, like the property of other utility companies, must be renewed from time to time, and that class of property, the life of which is terminated by the exhaustion of the gas fields. For the first class he used the inspection method, just as Mr. Uebelacker did, and accepted the latter's figures as to the amounts to be deducted for depreciation. He also used the inspection method in depreciating the local distribution systems in each of the cities considered of sufficient size and impor-

tance to be supplied with artificial gas on the exhaustion of the natural gas reserves. For all classes of property whose reasonable expectancy extends beyond the 18-year period (except the distribution property which can be used in the artificial gas business) he determined the present value on the basis of its present age and future use, based on the life of the gas reserves being 18 years. Thus he amortized this class of property in the proportion to which the gas reserves have been exhausted, as testified to by R. E. Davis, plaintiff's geologist.

He submitted the following illustration of the application of his method. Assume that the age of a unit of property is 10 years and that its normal expectancy is not more than another 10 years, a total life of 20 years. In such case its life is not affected by the life of the gas reserves and the inspection method of Mr. Uebelacker is accepted. Suppose, however, that the age of a unit of property is 9 years and its normal expectancy is 18 years or more. The total life of the unit for the purpose of the plaintiff is 27 years, of which 9 years, or one-third, is spent. It is therefore in *66⅔* per cent condition, for no replacement of the unit is necessary and the investment therein will have been restored to the plaintiff on the exhaustion of the field through the operation of the depreciation or amortization charges.

> "To apply the inspection method in this instance, where the physical condition may reasonably be 90 per cent, would result in a charge against the public for the gradual retirement of the property over 18 years with such capital being returned to the owners for investment elsewhere, while the return on practically the full reproduction cost is is being included in the operating expenses of this utility for such entire period. This clearly results in a duplication of costs."

("Hagenah, Ex. No. 1", R. 1164.)

The results of Mr. Uebelacker's observation as to deterioration are fully shown in his Exhibit No. 1, especially in his "Summary of Valuation", (R. 536-538), where he segregates the properties into four divisions—Production, Transmission, Distribution and General—and records the estimated reproduction cost of each of the principal items of property in each division, both new and less deterioration.

Similarly, Mr. Hagenah in his "Summary of Appraisal" and accompanying tables (R. 1166-1177) gives the result of his reckonings, using the combined theories of observation and amortization, as heretofore outlined. His methods clearly appear from these tables. In the numerous instances where he approved the application of the observation principle, he accepts Uebelacker's figures. In others, after accepting Uebelacker's estimate of reproduction cost new, he determines the present per cent condition of each unit or class of property based upon the relation of entire period during which it will be used (called "life") assuming the future life of plaintiff's gas fields to be 18 years. (R. 1169-77.)

In discussing the allowance claimed by plaintiff for amortization of its property, plaintiff adopts the principle for which Mr. Hagenah contends, stating it impressively in the following language at page 52 of its brief:

> "There is a radical difference between a company engaged in producing, selling and distributing natural gas and one whose business is supplying artificial gas, electricity or water. The commodity supplied by the latter may for practical purposes be considered as inexhaustible. The former resembles a mining or an oil company in that the product which it purveys, when once consumed, cannot be renewed and is gone forever.
>
> "It necessarily follows that such portion of the

physical plant of a natural gas company as cannot be commercially used for other purposes when the supply of gas is exhausted then becomes worthless apart from such salvage value as the material composing it may have"

The result of this summarized appraisal was that for 41.5 per cent of the present reproduction cost of the depreciable physical property as estimated by Uebelacker, Mr. Hagenah adopted the same method and reached the same conclusion as did Uebelacker, but for 58.5 per cent he adopted the amortization method. They arrive, respectively, at the following depreciated values of the physical property:

	Uebelacker (R. 536)	*Hagenah* (R. 1166)	*Difference*
Production System (Exclusive of Leaseholds)	$ 7,830,400	$ 7,389,894	$ 440,506
Transmission System	11,154,326	9,713,397	1,440,929
Distribution System	2,694,806	2,633,268	61,538
General Property	594,742	576,305	18,437
	$22,274,274	$20,312,864	$1,961,410
Overheads	6,357,046	3,656,316	2,700,730
	$28,631,320	$23,969,180	$4,662,140

The difference in overhead valuations is, of course, attributable largely to the manner of estimating the allowances therefor, a matter already discussed. On the physical properties, Mr. Hagenh's finding is less than Mr. Uebelacker's by $1,961,410, most of which occurs in the transmission system, which, as noted above, must be abandoned and will be worthless, except for salvage, when the gas reserves are exhausted. There is no justification for charging the public with a return on practically the

value new of property which will be abandoned at a definite date, for reasons not connected with its own structural condition. The principle of actual and observed depreciation has, we submit, no application to such properties.

We direct the Court's attention to the Commission's criticism that Hagenah would have it "speculate as to what may become of this physical property when the gas fields with which it is connected are exhausted", and "assume that the cities of Charleston and Huntington will be supplied by artificial gas plants", and its conclusion "This theoretical procedure advocated by Mr. Hagenah must give way to the facts as found by Mr. Uebelacker" (R. 87). The Commission went afield here. The "speculation" and "assumption" referred to were not made by Hagenah to justify his amortization of certain portions of plaintiff's property, but as reasons for his application of Uebelacker's observed deterioration method to portions of plaintiff's distribution system. **Mr. Hagenah accepted the observed deterioration findings of Mr. Uebelacker as to those portions of plaintiff's property which he considered would be available for use in the artificial gas business.** Property of this class was properly considered to have an indeterminate life. Mr. Hagenah measured its value by its condition, as in the *Electric Gas & Electric* case. While applying the principle of that case, he made a distinction as to property which has a limited life only.

Furthermore, the time will come when the consumers will have returned to the company through annual amortization provisions, say, 95 per cent of the value of the property, leaving only 5 per cent left to repay, and yet

according to Uebelacker's theory of accrued depreciation, they will still pay rates based on a fair value which is 90 to 95 per cent of the value new. The unfairness of this situation is apparent. It was so recognized by the District Court:

> "The protestants' expert, Mr. Hagenah, calculates the depreciation at $11,421,972. The principal and indeed the only substantial difference between him and Mr. Uebelacker is that the latter took into account nothing other than the observed physical depreciation, while he held that, when the normal life of any item of the plant will probably or certainly be cut short by the depletion of the supply of gas, it should be treated as now proportionately less valuable, because, no matter in how good physical condition it is, it has already run out a part of its definitely limited span of life. There cannot be room for much difference of opinion that a pipe line, which will lose all its value at the end of say eighteen years, because there will no longer be any use for it where it is and because it will cost more to dig it up than it will be worth when brought to the surface, is not in any reasonable sense of the term worth as much as would be one out of which forty years of useful service can be expected. From the standpoint under consideration, it would make little or no difference whether the pipes had been newly laid or had been in the ground for years. In either case, they would be efficient for eighteen years, and after that they would both be equally valueless. **Logically, Mr. Hagenah would seem to have followed the right method of ascertaining the present fair value of the property.** On the other hand, Mr. Uebelacker would be correct if what the plaintiff is entitled to earn is to be figured with the primary purpose of preserving to it the money it has prudently invested in the public service. Nevertheless, the Commission rejected Mr. Hagenah's and

accepted Mr. Uebelacker's figures for depreciation."

(R. 1245-1246, 14 Fed. 2d. 215.)

(C) ESTIMATED HISTORICAL COST

On the theory that prior to 1915 the books of the plaintiff do not present a satisfactory record of the cost of plaintiff's properties, Mr. Uebelacker, in lieu of a report on book cost, prepared in great detail the "estimated historical cost of the physical property" as of December 31, 1923. In this estimate he valued all property now in existence and installed prior to December 31, 1915, at prices representing the average during the ten-year period 1906-1915. He determined the cost of all property installed since 1915 from the records of the company, which showed the net cost of additions and retirements during the period. "This method was found to give the most accurate and practical determination of historical cost." ("Uebelacker Ex. No. 3", R. 554.) The figure thus arrived at, including overheads, but exclusive of natural gas rights, working capital and going value, is $25,090,788.00. (R. 550.)

The Commission analyzed this report. It points out that the fact that during the period prior to 1915 the average market price rather than the actual price was used would naturally account for some variance between Mr. Uebelacker's historical cost and Mr. Jurgal's book cost. (R. 90.) However, the more substantial difference is owing to Mr. Uebelacker's use of the same direct overheads (R. 91) for the period of 1906 to 1915 as were used in connection with the reproduction cost estimate as of December 31, 1923, and the same general overheads except that interest was taken at 6 per cent. instead of 8 per cent. (R. 210, 559.) The general overheads alone amount to $4,449,333, although the plaintiff since the in-

ginning has charged practically nothing for such items. (R. 406.)

The allowance of these overheads is, we think, shown to be unsound by Mr. Jirgal for reasons pointed out by him. (R. 406.)

The Commission rightly concluded that the historical cost estimate of Mr. Uebelacker more nearly represented estimated reproduction cost. (R. 91.) However, it was one of the "relevant facts" considered by the Commission in fixing the present fair value at $25,000,000.

(D) BOOK COST OF PHYSICAL PROPERTY

As said by the District Court (R. 1246), had the estimate of reproduction cost been the only evidence of value in the record, no doubt the Commission would have fixed the present fair value of the physical properties at $28,370,988. (Judge Rose through arithmetical error computes Uebelacker's depreciation allowance at $8,433,105, instead of $8,423,105. He thus arrives at a total reproduction cost new less depreciation estimate $10,000 less than the figure fixed by the Commission.) Despite the fact that counsel for plaintiff insisted on treating "reproduction cost new less depreciation" as synonymous with "present fair value", there was other material evidence of value before the Commission, notably book or investment cost, as as calculated by Jirgal from the plaintiff's books and the "estimated historical cost" report of Mr. Uebelacker, above referred to.

In his "Exhibit No. 3" (R. 1081-1116), Jirgal submitted a detailed study of the investment cost of all of the properties, including both the physical properties and gas rights, acquired by the plaintiff company. A searching analysis of the financial side of the organization of the company appears at pages 1081 to 1090 of the record.

As hereinbefore shown, the company was organized in 1909, and within two years acquired certain gas rights of

the original United Fuel Gas Company, the Hope Natural Gas Company and the United States Natural Gas Company. It acquired a transmission and distribution system from the latter company. Prior to this consolidation, such gas rights and other properties had been given a value and carried upon the books of each constituent company. The price paid by the plaintiff, partly in cash and partly in debenture bonds, bore no relation whatever to this book value. In the case of the United States Natural Gas Company, the price paid was $2,081,250, while the net assets carried to the books of the plaintiff showed $4,073,898.74. A report of the assets of the plaintiff and their source immediately after the purchase showed (R. 1081-1084):

United Fuel Gas Company (Old company)	$ 1,114,013.25
United States Natural Gas Company	7,116,119.70
Hope Natural Gas Company	8,392,072.90
	$16,622,205.85

This total furnished the principal basis for the finding by the commission of the rate base of $16,000,000, representing "actual investment" as of December 31, 1915, in the early rate case, No. 482. (*Re United Fuel Gas Co.*, 1 P. S. C. W. Va. Dec. 238.) In 1911 the plaintiff made an appraisal of its physical properties (transmission lines, wells, etc.). It had previously assigned a value of $5.00 per acre to its gas rights. The appraisal of the plant, however, left approximately $2,000,000 unassignable to any property. It became necessary, therefore, to reappraise the leases, which was done, and as a result thereof the aggregate of these appraised values *exactly absorbed the $2,000,000 excess carried on the books.* Such is the

history of the "book cost" of the gas leases, as the term is used in this case. (R. 1084.)

The value of the physical property was fixed by the appraisal of 1911, which value together with the net additions to December 31, 1923, as worked out by Mr. Jirgal in Exhibit No. 3, resulted in the figure of $19,945,582 ("Cost of Property and Plant Adjusted", less acreage, "Jirgal Exhibit No. 1", R. 1071, 1072), the book cost of the physical properties. It can certainly be no ground for complaint by the plaintiff that Judge Rose was thus induced to say that for its tangible possessions the plaintiff "*had paid* up to December 31, 1923, $19,945,582.16". (R. 1240.)

(E) REPRODUCTION COST MEASURED BY INDEX FIGURES

Mr. Hagenah submitted one estimate of present value to the Court which was not presented to the Commission (R. 484.) It is the estimate of reproduction cost based on the index numbers of the Department of Labor, referred to by Judge Rose. His method was to reduce Mr. Jirgal's book cost figures to 1924 dollars. The result was an adjustment in the value of physical property from $19,945,579 to $24,545,809. That this figure falls short of the reproduction cost new estimate of the engineers is due to the fact that the book cost includes none of the general overhead charges estimated by the engineers. A further reason is probably that the record of the change in price of items of public utility cost during the war and post-war years shows an increase somewhat greater than the average of the cost of commodities generally. (Hagenah, R. 485.)

(F) INCOMPLETE CONSTRUCTION

The protestants contend that the item of incomplete construction submitted in the last days of the hearing before the Commission should not have been considered by that body. The issues of the cause were joined as of

December 31, 1923. That was the valuation date adopted by the plaintiff. The engineers for both the plaintiff and the protestants made their findings as of that date. Complete accounting analyses of the operating results of the company, as well as the analysis of its book cost, were also brought down to that date.

In order that the issues may be fairly joined, the evidence must be based upon some specified date, which this Court has frequently referred to in rate cases as the "valuation date"; otherwise, either side, during the last moments of the hearing of the case, could introduce evidence which the other side would have no opportunity to combat. This is exactly what happened in the present case.

There are further reasons why this evidence should not have been considered by the Commission. It is clearly shown that most of these additions were placed in operation in December of the year 1924, and, therefore, had not been devoted to the public use in excess of one month. It does not appear how much of the new construction represents actual new property and how much consists of replacements financed out of the depreciation reserve. The company made only partial showings of the earnings and expenses for that year, none of which could be examined by the protestants in the way in which the other exhibits of the company had been analyzed. And, more important than this, the Commission had no opportunity to examine it, and Chairman Stathers' opinion shows clearly that he was forced to make the most general kind of estimates for the year 1924. (R. 133.)

The Commission allowed $600,639.45 for 1924 construction which had been completed up to November 30th of that year. The protestants think that upon the present record the Commission should not have considered construction expenditures, or the estimated operating results

for the year 1924. The District Courts, in both the West Virginia and Kentucky cases, apparently took this view, as both Courts based their consideration of the case upon the figures for the calendar year 1923. Judge Rose was of opinion that the 1924 additions and operating results were matters to be brought before the Special Master. (R. 1274.)

G. SUMMARY

The following evidence of the value of the physical property was before the Commission and the District Court:

Submitted to the Commission:	
Reproduction cost new Less Depreciation—	
By Uebelacker	$28,631,320
By Hagenah	23,969,180
Historical Cost—By Uebelacker	25,090,788
Book Cost—By Jurgal	19,945,582
Submitted to the District Court in Addition to the above—	
Reproduction Cost Arrived at by the Application of Index Number to Book Cost	24,546,309

The Commission weighed all of this evidence and Chairman Stathers concluded that the fair value of the physical property devoted to public use as of December 31, 1923, was $25,000,000.00. Commissioner Divine fixed the value at $26,000,000.00; the District Court said it was *not in excess of* $26,000,000.00, and Judge Hickenlooper fixed it at $26,283,844.00. The following language of the Commission indicates the full consideration which it accorded all of these various methods of valuation:

"As indicated in the opening paragraph, there has been developed fully for the Commission estimates of the reproduction cost, new and less depreciation, an estimate of the historical cost and the book cost of the property. Having these estimates the Commission is not dependent wholly upon any one of them as sometimes proves to be true. The Commission has before it for the years covering the life of the Gas Company, as represented by the book cost, and for the present, as represented by both the reproduction and the historical cost estimates, the prices and cost of material and labor during what is generally regarded as the 'period of high prices.' Likewise, it has before it the costs and prices prevailing prior and subsequent to such period. Giving consideration to the whole record, the Commission has had the benefit of all relevant facts and is in a position to find a value from such facts agreeable to the principles enunciated upon the subject of 'present fair value' by our own Supreme Court of Appeals and by the United States Supreme Court and cases there cited." (R. 91)

Plaintiff persistently takes the position in this suit that having accepted Uebelacker's estimate of the cost of reproduction new, his overhead allowances and his theory of depreciation, the Commission should have accepted his estimate of the reproduction cost new less depreciation, $8,8-631,320 as the fair value of plaintiff's physical property without considering any other evidence. The term "fair value" is not synonymous with "cost of reproduction less depreciation." It has been repeatedly held that there need be no slavish adherence to the cost of reproduction principle, or to any other one evidence of value. *Bluefield Water Works & Improvement Co. v. Public Service Commission*, 262 U. S. 679; *Georgia Railway & Power Co.*

v. *Railroad Commission*, 264 U. S. 625; *Minnesota Rate Cases*, 230 U. S. 352; *Smyth* v. *Ames*, 169 U. S. 466; *Kings County Lighting Co.* v. *Prendergast*, 7 Fed. (2d) 192; *Brooklyn Union Gas Co.* v. *Prendergast*, 7 Fed. (2d) 628. There can be no question that the Commission gave controlling weight to the cost of reproduction new less depreciation in its conclusion. *McCardle* v. *Indianapolis Water Co.*, 272 U. S. 400. But the Commission had before it the book additions by years as presented by Jirgal's Exhibit 6 (R. 1143) and it was thus informed of the very substantial additions which have been made during recent years, that is, during the period of high prices. In at least three or four of the years since 1916 the price level was higher than in 1923 and in none of the years since that date was it materially lower than during 1923. The table shows the substantial portion of company's physical plant built in the so-called high price years.

Year	*Per Jirgal Exhibit 6 (R. 1143)*	*Deduct Adjusted Book Cost of Gas Rights Per Jirgal (R. 1145, 1154)*	*Physical Property Exclusive of Acreage*
1909 to 1915, Inclusive	$17,278,315.88	$6,346,344.11	$10,931,971.77
1916 to 1923, Inclusive	9,010,595.95	$3,014.44*	9,013,610.39
Total	$26,288,911.83	$6,343,329.67	$19,945,582.16

*Red.

Substantially half of the property has been built in the period of high prices.

The difference between the book cost and the reproduction cost new less depreciation, as estimated by Uebelacker, is, as Judge Rose observes (R. 1242), almost altogether due to the liberality with which Uebelacker estimates the outlay which in reproduction would be made for direct and for general overheads, the latter alone being figured at $7,063,311.00.

Protestants contend that the Commission erred in accepting Mr. Uebelacker's view of overhead items and accrued depreciation. They contend that the view of their witness, Hagenah, should have been accepted on these points. Judge Rose sustains protestants on both points. If this had been done, the highest value of the physical property becomes $23,969,180, which is $1,000,000 less than the fair value found by the Commission.

2.—Working Capital

The working capital allowance of $990,000 is said by Mr. Uebelacker to include the amount shown on the company's books for materials and supplies on hand at December 31, 1923, and a reasonable allowance for cash in bank, together with two months' average operating expenses based upon the year ending December 31, 1923. (R. 520.) Mr. Hagenah accepted this allowance as reasonable (R. 1163) and it accordingly was adopted by the Commission.

3.—Going Concern Value

Plaintiff's bill does not challenge the Commission's allowance of $3,000,000.00 for going concern value. No assignment of error mentions it. A reasonable presumption, therefore, would be that plaintiff acquiesced in this finding of the Commission.

Mr. Uebelacker made no calculation of the going value,

as "such value cannot be arithmetically computed". (Uebelacker Ex. No. 1, R. 507.) Nevertheless, he did not mean to imply that such value was non-existent, nor that an allowance should not be included therefor. Since in his opinion the plant was in a state of 100 per cent working efficiency, and was a going concern with customers attached, as contrasted with a dead plant, he considered the cost of reproduction new without any deduction for deterioration to be the correct measure of the value of the plant. (R. 224.) Thus he completely absorbs the $8,423,105.00, his estimate of accrued deterioration, (R. 536) in a blanket allowance for going concern value. If it were really true that the difficulty of estimating and computing depreciation could be thus easily eliminated, there would be much to commend Mr. Uebelacker's theory of going value. However, an old plant does not have and cannot be adjudged to have value equal to that of the same plant and equipment new. Whatever of value the "going" business and the attached patronage may add to the concern, no sound reason can be advanced for identifying it with the accrued depreciation. The latter is neither measure nor guide of the former.

Mr. Hagenah recognized "going concern" as an element of value, and as a result of his analysis of many similar cases and a study of plaintiff's business and properties fixed $3,000,000.00 as a fair allowance therefor. (R. 429.) As stated above, this figure was approved by the Commission and the District Court. Judge Hickenlooper deemed this allowance extremely generous under the facts of this case, referring especially to the liberal overhead allowances.

> "The expert called for the protesting municipalities (Hagenah) has conceded the propriety of including an item of $3,000,000 as 'going concern' value in arriving at the present fair value of the complainant's properties. Although not contested,

we are not able to join wholeheartedly in this concession. There are cases in which the plant as an entirety has a value greater than the value of the component parts, but such value is difficult of computation, most uncertain in amount, and generally is the outgrowth of the expenses incident to assembling in one unit all the various parts which go to make up the whole. These expenses have received consideration in estimating overhead expenses during and prior to construction. So also the items of property have been valued as integral parts of the new operating whole, and as already charged with the attendant values as such, as well as with construction overheads. In addition to this general overhead charges of every conceivable kind have been included. Thus, as *direct or construction overheads* added to the labor portion of unit costs in valuation we find insurance, loss and use of tools, field supervision, timekeeping, and contingencies, and as part of the overhead, added to cost of material, purchasing, warehousing, and contingencies. In addition to these we find other *general overheads* added for engineering and superintendence, administration, interest, preconstruction costs, legal expenses, insurance and taxes, and cost of financing.

"It is extremely difficult to conceive of any other elements which might go into the property to increase its value as an entirety over the aggregate of component parts, and we must not, in the name of going concern value, sanction the inclusion of mere good will as predicated upon earning capacity. This position is well expressed by the Supreme Court of Iowa in *Cedar Rapids Gas Co. v. Cedar Rapids*, 144 Iowa 426, 120 N. W. 966, 48 L. R. A. (N. S.) 1025, 138 Am. St. Rep. 299, 223 U. S. 655, 32 Sup. Ct. 389, 56 L. Ed. 594, • • • As

previously intimated, the value of the plant is to be estimated in its entirety, rather than by the addition of estimates on its component parts, though the latter course will materially aid in determining the value * * * Save as above indicated, the element of value designated as "going concern" is but another name for "good will" which is not to be taken into account in a case like this * * * This language was cited with approval in *Des Moines Gas Co. v. Des Moines*, 238 U. S. 153, 35 Sup. Ct. 811, 59 L. Ed. 1244, in which the Supreme Court approved the disallowance of a 'going concern' value.

"The evidence does not satisfactorily distinguish between that going concern value claimed and good will, and in so far as we admit such item in the valuation we are of the opinion that it must be held to include all the disputed overhead charges. **Certainly we could not include a going concern value in excess of the $3,000,000.00 conceded.** Mr. Uebelacker originally included no allowance whatever for this item (See R. 536) and his estimate of a going concern value of $8,423,111.00 is wholly without reason or evidential support."

United Fuel Gas Co. v. Railroad Commission, 13 Fed. (2d) 521.

4.—The Gas Reserves

We agree with counsel for plaintiff that the principal item of controversy in connection with valuation in this case is the valuation of the gas rights of the plaintiff company. In its bill plaintiff alleges the present value of its gas rights to be "at least the sum of $30,000,000" (R. 116). Its witness Uebelacker testified that in his opinion plaintiff's gas rights had a value of $30,449,176.00. Other

witnesses for the plaintiff submitted estimates varying from $30,000,000 to $45,000,000. Protestants deny that any such value is established by the evidence. As hereinbefore shown, Mr. Jirgal testified to the "book cost" of the gas rights as shown by plaintiff's records. This book cost does not, as its name would imply, represent the actual cost to the plaintiff, but original cost enormously inflated by the various "appraisals" of plaintiff and its vendors. Commissioner Stathers adopted the figure submitted by Jirgal, $6,361,511.42 ($6,343,329.67 plus additions in the year 1924 of $18,181.75) as the best evidence of the value of the gas rights (R. 117). Commissioner Divine found the present value of the gas rights presently used and useful to be $10,500,000.00 (R. 135). He says that he arrived at this amount by a consideration of the value of the gas leases "as such", and the fact that the consumers have paid and in the future will pay more to maintain the leases than the company has invested in them (R. 137). Judge Hickenlooper, taking substantially the same view as Commissioner Stathers, rejected the evidence of appreciated value offered by the plaintiff as incompetent and approved the book cost figure as the best estimate of present value. *United Fuel Gas Company* v. *Railroad Commission*, 13 Fed. (2d) 510, 520. Judge Rose found it unnecessary to make a "definite finding" upon the question of the gas valuation, although it is evident that he held very decided opinions on the subject. The views of these several courts will be considered later.

Any analysis of the legal principles applicable to the question under discussion means little without a clear understanding of what is meant by the term "gas rights" or "gas reserves".

Many thousands of acres of West Virginia soil are underlaid with natural gas. At a depth of from two to three thousand feet under the surface this gas is confined under enormous pressure in the so-called "pay-sands".

As in other states the gas and oil fields are usually near each other. Often a well produces both oil and gas in paying quantities. Gas from oil wells, or "casing-head" gas is particularly rich in gasoline. When discovered by drilling and transported in pipes or "mains" to the centers of industry and population, the gas, frequently stripped of gasoline, becomes a most desirable and convenient fuel both for manufacturing and domestic purposes. Prior to 1900 gas wells were usually found by prospectors in their search for oil, and when discovered it was used in a haphazard way throughout the state for lighting and fuel. A great deal more was wasted in torches left burning in the fields, and in extravagant and poorly designed appliances. The new century, however, brought home the great value of the gas as an article of commerce and since 1900 no natural resource with the exception of coal and oil has made a more important contribution to the economic growth of the state. The use of natural gas in the homes of such cities as Charleston and Huntington, both from the standpoint of utility and economy, has been for years and is now one of the advantages in attracting residents to those cities. Large industries are induced to locate in the state because of the peculiar advantages of natural gas as a fuel. Many of these concerns are intervenors in this suit, protesting against an unreasonable increase in their rates. Some of them were induced to locate in West Virginia largely by contracts with gas companies for fuel gas for a term of years at very low rates, some as low as five cents per thousand cubic feet, which contracts were held later by the state courts and the Commission to be invalid. *United Fuel Gas Company* v. *Public Service Commission*, 73 W. Va. 571; *Randall Gas Company* v. *Star Glass Company*, 78 W. Va. 252. Gas is measured for sale by meters, the unit of measure being the cubic foot, and the unit price being based on each thousand (M) cubic feet delivered. An idea of the vastness of gas production as a business may be gathered from the fact that in the year 1922

the plaintiff sold in excess of forty-six billion cubic feet (46,867,511,000 cubic feet) to its customers within and without the state. Of this total 14,872,918 M cubic feet were sold to retail consumers, and the remainder, 31,994,593 M cubic feet, to so-called wholesale purchasers. These wholesale customers whose names, together with the respective quantities purchased by each, appear at page 1134 of the Record, are public utility companies who purchase gas for transportation and resale outside of the area supplied directly by the plaintiff.

A considerable amount of gas is purchased by the plaintiff. Such purchases are treated as an operating charge. For the year 1923 the gas purchased amounted to 9,669,753 M cubic feet at a cost of $619,263.69, or at an average price of 6.4 cents per M cubic feet. (Jirgal Ex. No. 5, R. 1137). Such purchases are not the result of plaintiff's inability to supply all demands but are made because it is able to buy gas cheaply and thus conserve its own gas supply. (Davis, R. 968.)

(A) GAS RIGHTS OWNED IN FEE

On December 31, 1923, plaintiff (together with its subsidiary, the Warfield Natural Gas Company) was seized of the fee title to 41,969.47 acres of minerals, i. e., oil and gas. (Part I, Davis Exhibit No. 1, R. 713). A small amount of this, 43.2 acres, was oil only. Plaintiff is not in the oil business and when oil is discovered it is turned over immediately to the Ohio Fuel Oil Company, an affiliated corporation. The report of Mr. Davis shows that the plaintiff owns the surface rights in but 131.68 acres of its mineral lands.

(B) LEASEHOLDS

On the same date the plaintiff had so-called leases of the gas under 772,941 acres of lands in West Virginia and Kentucky, illustrative copies of which were filed in the District Court as "Jay Exhibit 3 J. C. No. 2" (R. 1031).

These copies were not before the Commission. There Mr. Davis referred to the leases as "the usual lease contract" and the Commision was limited to its general knowledge of gas leases and their usual terms and conditions. Opinion of Commissioner Stathers, R. 108). "Jay Exhibit 3 J. C. No. 1" (R. 1014), filed upon the hearing in the District Court, undertakes to summarize the more important provisions of the plaintiff's gas leases, although many leases frequently contain clauses not found in others, depending upon the demands of the lessor and the extent to which the company is willing to go in order to obtain the lease. Most gas leases are for a term of years and so long thereafter as gas is produced in paying quantities. Usually there is a cash consideration or "bonus", for the making of the lease, the amount of which ordinarily depends upon the acreage. The leases commonly provide for an annual or delay rental which, if a well is not drilled within the period stipulated, must be paid at stated intervals to keep the lease alive. If the tract is not drilled within the term of the lease, the lease must be renewed or a new lease taken. Such a renewal frequently requires an additional "bonus" or "renewal" charge. If gas is produced in paying quantities during the term of the lease the "delay" rentals usually terminate and thereafter a "royalty" is paid. In the case of gas the royalty is ordinarily a flat sum varying from $100 to $500 per well, although occasionally, as in the case of oil, the royalty is an agreed percentage of the production. In many cases the lease is for both oil and gas and sometimes where oil is the chief consideration to the lessor there is no provision for gas royalty. Lessors occupying positions of vantage occasionally require express forfeiture provisions, which operate in case of failure to drill within a specified time. Examples of all of the types here discussed appear among the many leases of the plaintiff. "Jay Exhibit No. 3 J. C. 1" (R. 1014-1030) shows "delay rentals" from twenty-five cents to twenty dollars per acre. A rental

higher than two dollars, however, is rare, and the average is around one dollar. In his report of the book cost Jirgal made a study of the original or bonus cost of the acquisition or renewal of the company's leases and found that the average cost thereof per acre during the period 1910 to 1923, inclusive, was forty-three cents. The highest average cost (eighty-three cents per acre) was during the period 1921 to 1923, which included an extraordinary payment of $25,000.00 for seventy acres in Kanawha County. Excluding this unusual transaction the average cost during the three years remained forty-three cents. (R. 1087.) It was further pointed out by Jirgal that the bonus payments bear a definite relation to the delay rental charge. In unproven territory where the annual rental charge is one dollar per acre, the bonus or down payment amounts to one quarterly rental or twenty-five cents per acre. In proven areas where the delay rentals range from $150 to $500 per well one annual rental is paid as a bonus. During the entire life of the company the renewal charges, amounting to $340,541, have been included on its books as a part of its capital account, and have been included by Jirgal in his estimate of book cost. (R. 1088, 1099.)

Three observations of Mr. Jirgal in connection with this study deserve notice (R. 1089-1090):

(1) "The bonus or leasehold payments on acreage renewed shortly after the original purchase (of leaseholds by the plaintiff in 1909) were considerably less than the original valuation assigned."

(2) "The company has included in its property account, both the original value placed upon the acreage and the bonus paid upon any renewals to date. Practically all of the acreage has been renewed at least once and in numerous instances twice since the original purchase."

(3) "The cost of reproducing the acreage today on a bonus payment basis is evidently less than the book value."

The rentals, royalties and the expense incident to the procuring of the leases have been carried on its books as an operating charge by the plaintiff and uniformly allowed by both the Public Service Commission and the Courts in West Virginia as such operating charge against the consumers. From June 1909 to December 31, 1923, the rentals and leasehold expenses amounted to $7,126,454.33 (Jirgal Ex. No. 3, R. 1091), exclusive of royalties. The royalties during the same period amounted to $1,691,455.63 (Opinion of Commissioner Stathers, R. 117; Jirgal Ex. No. 3, R. 1151, line 12). The attention of the Court is especially directed to the fact that the plaintiff has always carried on its books as operating charges all payments made by it in connection with said leases, except original and renewal "bonus" payments, (which have been capitalized) and that such payments (except said bonus payments) have been allowed as proper operating expense by both the Commission and the Court in this proceeding.

(C)—PLAINTIFF'S VALUATION OF GAS RESERVES AS REPORTED BY ITS ENGINEER, R. E. DAVIS

The principal foundation for plaintiff's estimate of the value of its gas reserves is the report of its engineer and geologist, Mr. R. E. Davis, of Pittsburgh, Pennsylvania. He made a survey of all of the gas lands controlled by the plaintiff and embodied his findings in a two hundred and fifty page report and several geologic maps, all of which appear in the record as Davis Exhibit No. 1. For the purpose of his investigation the plaintiff and its two subsidiaries, the Warfield Natural Gas Company and the Cabin Creek Gas Company were treated as one. In the whole study the location of each area with reference to producing territory was considered the best evidence of value. His study is founded on two premises:

(1) That gas leased is as fully the property of the

plaintiff as gas owned in fee, wherefore, he made no distinction between the fee lands and the leaseholds, (R. 269), and

(2) That the value of the gas rights is the value of the recoverable gas in the ground.

The result of his study was a classification of all plaintiff's holdings into six classes:

(a) Proven gas territory.
(b) Probable gas territory.
(c) Proven oil territory.
(d) Probable oil territory.
(e) Possible gas or oil territory.
(f) Unfavorable territory.

(a) PROVEN GAS TERRITORY. Mr. Davis defined proven gas territory as those areas "which have been thoroughly tested and which are now producing gas". (R. 711.) The production and rock pressure records of most of the wells of the plaintiff, and some of other companies, being available, it was Mr. Davis' opinion that the Boyle's Law, or rock pressure method, could be used with a "high degree of confidence" for the purpose of estimating the quantity of gas contained in said land and leaseholds. (R. 730). Table No. 4 of Davis Exhibit No. 1, (R. 847, 952) consists entirely of the production and rock pressure records of the many wells in the plaintiff's gas producing territory. This method is based upon the discovery two hundred years ago by Robert Boyle that the volume of gas varies inversely with the pressure, a proposition generally accepted by scientists since that time. Given the total production of any well, together with the decline of rock pressure (the pressure existing in a gas sand being measured in pounds above atmospheric pressure) during the production period, it is theoretically possible, according to Mr. Davis, to calculate the quantity of gas

remaining in the well. (R. 241.) His actual method was to divide the whole territory into small areas or groups of wells, according to the similarity of their natural characteristics and age, determine the average rock pressure for all of the wells in each group, and from a study of past production records, arrive at the volume of gas remaining in such area or group of wells. The gas content of a proven territory is therefore based on the proposition that "the same production will be obtained in the future for each loss of one pound rock pressure that has been obtained for a number of years in the past". (Davis, R. 237.) Graphs showing the relation of the decrease in production to the decline in rock pressure for each area are included in Table III of Davis' report. (R. 761-810.) Mr. Davis included as "proven territory" 136,384 acres. He concluded that his investigations indicated total estimated gas content in the proven territory as of December 31, 1923, amounting to 249.1 billion cubic feet. (R. 237.)

(b) Probable Gas Territory. In the case of probable gas territory there were no production or pressure records to aid the investigator.

Mr. Davis prefaced this section of his report as follows (R. 735):

> "The estimation of gas reserves of territory which has been classed as probable is natually a difficult and uncertain undertaking. Here we are dealing with territory which is believed, from a careful study of all pertinent facts, to be gas territory, yet had it been sufficiently drilled to prove the correctness of this conclusion, it would be proven territory. **Estimates made therefore of the probable territory must be considered as much less trustworthy than those made of the proven territory.**"

In the absence of records, recourse was had to the

method of comparing each given area with the nearest proven pool in the same sand, subject to such modification as might be indicated by outlying test wells. (R. 735.) Mr. Davis' direct testimony (R. 238) is remarkably brief and vague as to the method employed in determining this comparison. Because of this brevity and of the fact that "probable acreage" constitutes an alleged element of value more important, according to plaintiff's figures, than all other factors, we prefer to quote the record of Davis' testimony on the subject (R. 238):

> "In estimating the reserves of this probable territory he first found what the production of gas—that is, what the total reserve gas—has been per acre in the nearby adjoining proven and developed acreage. In estimating the reserve area classed as probable he found what the reserve is on the nearby proven acreage. For example, referring to Sheet No. 2, on which there is shown the greater portion of the Clendennin pool, the reserve of that pool, or the total production of that pool, has been determined as approximately 7.1 million cubic feet per square mile for each pound of rock pressure, that this determination was made by him. Referring again to sheet No. 3, let us say there is one square mile of territory classed as probable, and that that territory should be ranked as having a reserve which will produce 7.1 million feet per pound per square mile. The witness then determined what the gas reserve would be on that basis, and then modified that estimate, never increasing it, but generally decreasing it, to take into account the possibility that some acreage may not prove productive, or that some gas will be drawn by competitors. The average discount applied to the entire probable acreage for this purpose has been 38 per cent. That the witness found what the reserves in this probable territory

would be were it as good as the nearby proven territory, and then discounted that on the average 38 per cent to take account of the two things above referred to. That applying this method to the acreage indicated as probable, the witness finds that there is a total of 414.6 billion cubic feet of gas therein, making a total of 663.7 billion cubic feet in all of the acreage classed by him as proven and probable on the maps."

There is no explanation of the 38 per cent discount figure.

He made no allowance for merely "possible" or "unfavorable" gas territory, but with his estimate of the volume of the gas content of the proven and probable acreage as a basis, he filed his "Exhibit Z" (R. 950-982), in which he undertook to establish the present value of the gas reserves. This study is grounded upon a fundamental assumption "that the property of the United Fuel Gas Company might be placed in use in whatever way is most advantageous to the owner of the property" (R. 244.) According to the witness, the most advantageous market available to the plaintiff company is the Pittsburgh Industrial District, where, in competition with other fuels, he reckoned that the gas should be worth at least thirty-five cents per M cubic feet. Upon this basis, Mr. Davis prepared a series of tables, particularly "table No. 5" (R. 978) in which he estimated that the plaintiff was in position to deliver to the Pittsburgh market 631.6 billion cubic feet of gas over a period of eighteen years. Deducting the estimated transportation cost and line loss from Cedarville on the state line to Pittsburgh, the value of the gas at Cedarville throughout the eighteen years was fixed at 27.99 cents per M cubic feet, the net value after deducting all operating costs at a figure varying from 16.845 cents for the year 1924 to 14.247 cents for the year 1941 and the present worth of the property useful for the serving of the

new but theoretically available market, after applying a compound discount factor based on eight per cent value of money and deducting federal taxes, at $52,181,538.17. Deducting the present reproduction cost of those portions of the physical property necessary for conducting this hypothetical business, less depreciation, as calculated by plaintiff's witness Uebelacker, the present value of the natural gas fee and leasehold property was found to be $32,458,129.17. (R. 973.)

It is pertinent here to note the criticism of Judge Rose (R. 1257) that in his "Table No. 5" Mr. Davis for some reason involves in his calculations 38.6 billion cubic feet of gas which he estimates plaintiff will purchase during the next eight years. As the Court says, this gas has no place in a valuation of plaintiff's property, and the profit therefrom, $4,967,291.46 (Judge Rose) should be deducted.

We have outlined Mr. Davis' method of valuation because it constitutes a considerable part of the record, and particularly to show the many assumptions and hypothetical situations which compose the basis for his findings, circumstances which have appeared of importance to other courts in their consideration of the plaintiff's gas rights. However, the plaintiff goes only part of the way with its geologist. While accepting his estimate of the volume of the gas content, the bill makes no reference to the valuation of Mr. Davis, but refers to the valuation arrived at by Mr. Uebelacker, $30,449,176. (R. 10.) It is not disclosed whether this choice was owing to a preference for the reasoning or for the result of Mr. Uebelacker's estimate.

(D)—MR. UEBELACKER'S VALUATION OF THE GAS RIGHTS

Mr. Uebelacker, in introducing his report on the value of the gas rights, said:

> "Leaseholds and natural gas rights, proven and probable, have been included in the valuation at an

amount computed as *the value of the estimated remaining gas content* of the proven and probable acreage.

"The principle involved may be stated as follows. The measure of the value to the owner or lessee of gas in the ground is the difference between the prevailing market price at which such owner or lessee can purchase gas delivered to the field mains and the cost to such owner or lessee of producing and maintaining with his own wells an equivalent supply of gas at the same point of delivery."

(Uebelacker Ex. No. 1, R. 520-521.)

In arriving at the value of plaintiff's gas in the ground it was necessary for Mr. Uebelacker to make three estimates.

(1) The amount of recoverable gas controlled by plaintiff. He did this by adopting Mr. Davis' estimate of 663,108,431 M cubic feet.

(2) The prevailing market price. Mr. Uebelacker measured the market price by the prices paid to various producers by several purchasers of gas in fields near those of the plaintiff, and by opinions expressed as to what natural gas would sell for if delivered for industrial purposes at Pittsburgh, Pennsylvania. The following prices were taken as illustrative: 8c per M cubic feet paid by the South Penn Oil Company for gas delivered in the field; 16c per M cubic feet paid by the Owens Bottle Company, a Charleston manufacturer; 17c per M cubic feet paid by the International Nickel Company, of Huntington. Plaintiff's price of 22c per M cubic feet to the Hope Natural Gas Company (R. 522, *et seq.*), and the price for gas in the Pittsburgh industrial market were given especial consideration.

As pointed out by Judge Rose, (R. 1260), **Mr. Uebelacker found the Pittsburgh price to be 30c per M cubic feet, as contrasted with Mr. Davis' figure of 35 cents** (R. 527), **producing a difference of over $30,000,000 when applied to Mr. Davis' estimate of gas content.**

(3) The total unit cost to the plaintiff of production and maintenance, including operating expenses, depreciation, amortization of equipment and a fair return.

He arrived at the value by deducting the production cost, so determined, from the prevailing market price as estimated in the foregoing paragraph. It is unnecessary to review here the details of Uebelacker's calculations, all of which are graphically shown in his Exhibit No. 1. Briefly, his method was to estimate what it would have cost the plaintiff to supply gas to each of the buyers mentioned above at the same points of delivery. Such estimated cost included not only all costs of production and transportation, but additional allowances for depreciation, depletion, amortization and a fair return. Presumably, Mr. Uebelacker deducted the average of the production costs so ascertained from the average of the current and estimated market prices found by him. At any rate, he says that "based upon a review of these results, he assumes a fair and reasonable value of the gas in the ground of not less than $0.05 per thousand cubic feet. (R. 535.) The consequent total of the proven and probable acreage (Davis' estimate) was estimated by Uebelacker to be $33,155,421.55. He made no attempt to reduce this amount to present value, despite the evident impossibility of marketing the entire 663 billion cubic feet of gas except over a long period of years. Employing Mr. Davis' estimate of 61.64 cents as the present worth of a dollar to be returned over 18 years, Judge Rose adjusted Mr. Uebelacker's estimate to $20,455,254.00. (R. 1260.)

Mr. Uebelacker also adds an estimate of the value for the "possible" or "wild-cat" territory, 552,319 acres. This

he includes at $5.96 per acre, the "cost of acquisition in 1923", thus adding the additional sum of $3,293,754.00. (R. 535.) This is a most startling calculation, and since Mr. Uebelacker furnishes no detail of his 1923 acquisition cost of $5.96, it is inexplainable. In view of the analysis of the acquisition cost of unoperated acreage by districts for each year since 1909 furnished by Mr. Jirgal (R. 1102-1106) the figure of $5.96 must be definitely challenged. At pages 1100-1101 of the record Mr. Jirgal shows that the average acquisition cost per acre for all unoperated acreage during the period 1921-1923, including the extraordinary payment of $25,000 for 70 acres hereinbefore referred to, was *just 83 cents*. At page 1106 Mr. Jirgal further shows that in the year 1923 the company secured 15,184.02 acres at a cost of $10,320.99, or about 66 cents per acre.

(E)—VALUATION ESTIMATES OF "PRACTICAL GAS MEN"

Plaintiff introduced five witnesses who gave their opinions as to the value of plaintiff's gas rights, not as a result of a technical investigation, but from the standpoint of practical oil and gas men. Each of these gentlemen was interested in gas development companies operating properties similar to those of the plaintiff. Mr. Sullivan, Mr. Corrin, Mr. Gregory, Mr. Womack and Mr. Davidson were each connected with companies operating fields very near to plaintiff's leaseholds and either buying gas from or selling gas to the plaintiff. Their valuation estimates ranging from $30,000,000.00 to $45,000,000.00 were all arrived at on the basis of present exchange or market value of the gas in regulated markets. There was no evidence of any nearby market capable of absorbing plaintiff's gas in the quantities now being produced. *No gas purchasing company is suggested other than public utilities subject to public service regulation.*

(F)—FALLACIES OF PLAINTIFF'S VALUATION OF GAS RIGHTS

As all of the estimates of the value of the gas rights submitted by Mr. Davis and Mr. Uebelacker are founded wholly upon the former's estimate of the gas content of the so-called "proven" and "probable" acreage, 6637 billion cubic feet, if this figure is shown to be untrustworthy, plaintiff's purported valuation of gas value accordingly falls.

(1)—MR. DAVIS ON "PROVEN TERRITORY":

Plaintiff takes the position that Mr. Davis' testimony on the gas content is uncontradicted. On the contrary, protestants' witness Hagenah filed three exhibits (Nos. 1, 2 and 3, R. 1163-1209) in which he pointed out the fallacies in practically every step of Davis' methods. However, throughout this proceeding, and all former hearings before the Commission, protestants have always insisted that the conclusions of Mr. Davis on this head were the result of speculation rather than calculation. The Commission and the State Supreme Court have consistently taken the same view. "His estimates are mere estimates and nothing more." (Opinion of Commission, quoting W. Va. Supreme Court of Appeals, R. 101.)

Upon the premise that the principle of Boyle's Law is fully applicable to natural gas accumulations confined in rock and sand formations three thousand feet under ground, Mr. Davis classifies 136,384 acres as "proven" territory, and estimates its gas content at 2491 billion cubic feet. (R. 737). He says this territory has been "thoroughly tested", and is now producing gas. (R. 711.)

Yet, of this area but 68,900 acres are classed as operated

and producing territory (R. 714). To quote Mr. Davis, "it would appear that about one-half of the proven territory has been drilled." (R. 219.)

(2)—PROBABLE TERRITORY:

In the case of the so-called "probable" territory, Mr. Davis' estimates have even less foundation in fact. As stated previously, he admits that such estimations are naturally "a difficult and uncertain undertaking" and must be considered as much less trustworthy than the estimates of the "proven" acreage. His method was essentially a guess as to the probable quantity of gas contained in numerous leaseholds aggregating 124,672 acres. A characteristic phase of his estimate of this territory is his treatment of the dry holes with which his "probable" territory is liberally sprinkled. He states that where a gas field **"can be followed for a given distance, say 15 miles, it is reasonable to believe that it will extend an additional two miles".** (R. 264.) It should be added that Mr. Davis maintained this belief despite the presence of a line of dry holes, his explanation being that "dry holes do not necessarily mean that all of the adjoining territory is dry", and "that as to some of the dry holes, they are in all likelihood a local condition." (R. 264.) It is upon such "likelihoods" that Mr. Davis estimated the content of the "probable" acreage to be more than 414 million thousand cubic feet, and upon which plaintiff asks that its patrons pay a fair return, in addition to the cost of acquiring and maintaining the acreage by the payment of the bonus and delay rental costs. In other words, the consumers are to be forced to speculate

upon the probabilities of an untried gas field, in addition to paying all of the carrying charges and incidental expenses necessary to keep the leases alive.

As evidence of the accuracy of his judgment, Mr. Davis testified that subsequent to his survey one hundred and ninety-seven wells had been drilled by various companies in the territory classified by him as "probable". Of these wells, one hundred and seventy-four were "producers" and twenty-three were dry holes. However, he is entirely silent as to the volume of the producing wells and as to whether their production bore out his estimates of the recoverable gas. (R. 273.)

Before undertaking to discuss in detail the evidence of Messrs. Davis, Uebelacker and other witnesses of the plaintiff who testified in the present proceedings as to content and value of plaintiff's so-called gas reserves, it will be of interest to trace the history of these gas rights, including the cost thereof to the plaintiff, and the development of the varying views and theories of the plaintiff in its efforts to require the consumers to pay not only the expense of acquiring and carrying its gas leases, but also of amortizing the present fair value thereof claimed by the plaintiff to amount to not less than $80,000,000. This history is available in the prior decisions of the Commission and Supreme Court of Appeals of West Virginia, upon previous applications of the plaintiff for increases in rates, many of which have been allowed.

In its first application before the Commission in 1916, (Case No. 482, 1 W. Va. P. S. C. Dec. 238), the company introduced as evidence of value of all its property used in the public service, its investment therein, as shown by its books. No attempt was made to value the gas rights separately, and the Commission adopted as the rate base the sum of $16,000,000, which was substantially the book cost of all of plaintiff's properties.

In the second case, (No. 585, 1 P. S. C. W. Va. Dec. 501, P. U. R. 1918 C 193) in the year 1917, the company separated its gas holdings into two classes:

Operated acreage	52,349 acres
Unoperated acreage	770,034 acres
Total	822,383 acres

In the year 1917 the company produced 39,290,000 M cubic feet of gas from 560 wells, a production not far below its production at this time.

Its witnesses made no attempt to speculate as to what portion of the unoperated lands were "probable" or "possible", but valued all of its leaseholds, both operated and unoperated, at the initial or bonus cost, $6.92 per acre. On this basis, the value of the unoperated leases aggregated $5,329,512.26. The Commision noted that "The rentals, taxes and other carrying charges upon this acreage is carried as a gas operating expense and paid from gas earnings". The company sought to include such value of all its leaseholds in the rate base. The protestants claimed that "the large investment in unoperated acreage imposed an unjust and unnecessary burden on the consumers, when required to pay rates sufficient to insure a fair return thereon, plus rentals and taxes". Upon this point of over-investment the following language from the opinion of Commissioner Wiles in that case is important:

> "We do not approve of the 'now or never' policy urged by counsel for applicant as ground for holding a vast acreage in reserve, upon the principle that it may otherwise be acquired by others engaged in the business of producing natural gas. We do not deem it necessary for the security of applicant's business that it control all probable gas territory in reasonable proximity to its production field or transmission lines. The applicant has an established business, consisting of many miles of trans-

mission lines and a number of large distributing plants. It is shown that applicant has been purchasing from other producers a little more than one-fourth of the gas produced and sold by it, at a price that seems somewhat less than the cost of production to the applicant company. It therefore seems superfluous to say the mere fact the applicant does not own all the producing gas acreage in proximity to its fields and lines necessarily means it will thereby be deprived of the gas production therefrom. As a matter of fact, judging from applicant's past experience, and our general knowledge of its location and strategic situation it seems more than probable that it should be able to procure gas produced from adjacent territory by independent operators at a reasonable price.

Under these circumstances we are of opinion that applicant has an over investment in unoperated acreage far beyond the reasonable reserve required for the future needs of its consumers. If a reasonable percentage of this acreage should prove productive, then the enhancement in value will compensate for the hazard of carrying a temporarily unremunerative investment. If it is barren, a reasonable amount of prospect drilling would establish that fact and the worthless area should be surrendered.

We are of opinion that the applicant should only carry at the expense of its consumers such undeveloped land as will insure uninterrupted service and an adequate supply of gas under a reasonable forecast of future conditions. If we, therefore, assume that, on account of exhaustion of its gas fields and increased consumption, the applicant will require one hundred and fifty additional producing wells each year to meet the depletion of wells and increasing demand, and that a reason-

able percentage of its undeveloped territory will prove productive, then it would seem that 50% of its present investment in unoperated acreage constitutes an ample reserve for the present rate period, and upon which it is entitled to earn a fair return. The reasonableness of this limitation is further apparent when it is remembered that the applicant is earning enormous profits from its oil and gasoline business, which are dependent for future expansion and development upon the probable productiveness of the undeveloped acreage held as gas reserve without making any substantial contribution to the expense of carrying charges or return upon the investment. We find the fair value of applicant's investment in unoperated acreage chargeable to its gas business to be $2,664,756.13."

Re Application United Fuel Gas Company, 1 P S C W Va Dec 501, 514

In the next case (*Re United Fuel Gas Company*, Case No 845, 1 P S C W Va Dec 651, P U R 1920 C 583) the gas company for the first time sought to capitalize the increased value of its gas leaseholds, or such part thereof as was actually producing gas. The opinion of the Commission, by Wiles, Chairman, is devoted mainly to a discussion of the facts as to the acquiring of these leaseholds and the theory and testimony of the plaintiff as to the valuation thereof, supplemented by a critical examination of the authorities for the legal principles applicable.

The gas company's exhibits and evidence showed that, as of January 1, 1919, its so-called gas reserves consisted of 753,666 acres, which it still divided into only two classes, namely: 56,874 acres of operated territory and 696,792 acres of unoperated territory. On December 31, 1918, plaintiff's gas acreage was carried on its books at an

investment cost of $6,597,224.91. It then set up upon its books, as representing the increased or appreciated value of its acreage, the sum of $31,778,111.42, making the total value of applicant's gas acreage as carried on its books $38,375,336.33.

The Commission again called attention to the fact that it had been the practice and custom of the gas company, when additional acreage was acquired from time to time, to charge to *capital* the expense of obtaining same, whether bonus, rental or purchase price, and thereafter to charge to operating expenses the delay rentals or royalties paid for carrying such acreage, stating that the "aggregate of the expense of acquiring this acreage is the sum at which it was carried upon the books of the company as investment on and prior to December 31, 1918", namely, $6,597,224.91.

Attention is called to the fact that applicant's unoperated acreage showed a decrease of over 73,000 acres during the two years preceding January 1, 1919, while its operated acreage had increased during the same period only 4500 acres.

The plaintiff sought to sustain its item of $31,778,111.42 added to its capital account, and claimed by it as a proper item of its rate base as the increased or appreciated value of its gas acreage, by the testimony of three witnesses, Mr. Wyer, its engineer expert, Dr. I. C. White, a geologist, and John Davidson, a producer and seller of gas, who is the same witness who testified both before the Commission and the Court, in the present proceeding.

Concerning the character of the evidence offered, Wyer testified to a valuation of $29,860,500.00, or an increase over investment cost of $23,263,276.00, upon the basis of the exchange or market value of said acreage. Dr. White fixed a valuation of $42,000,000.00, upon the assumption that the gas company was earning, at its present rates, a **profit of six cents** per thousand upon the gas it was producing and selling, and that it would

earn an equal amount upon the gas yet remaining in the ground, which he estimated plaintiff's acreage would produce before exhaustion. John Davidson fixed a valuation of $32,711,770.00, assuming that the company would make a profit of about 3½ cents per thousand cubic feet upon the gas which this acreage would produce. He added an additional $10,000,000.00 on account of the value of the extraction of gasoline from the gas contained therein.

The Commission defined the questions presented as follows:

> Assuming that the market or exchange value of applicant's gas acreage has appreciated to the extent claimed by its witnesses in excess of investment cost, is the applicant entitled (a) to capitalize such increased value and require its consumers to pay a reasonable return thereon; and (b) to require as well the creation of a reserve for depletion so as to amortize and return to the stockholders this appreciated value when such gas acreage is exhausted?
>
> Further, assuming that the gas company is entitled to add to capital account the accrued appreciation in the value of its gas acreage, can the Commission accept as the measure of that value a sum based upon either the market or exchange value of such acreage, or upon assumed profits that will arise from the sale of the gas contained in such acreage at a profit dependent upon rates, the reasonableness and propriety of which are in question, that is to say, can a basis of value be considered in a rate case which is dependent upon a rate fixed, or to be fixed, when the rates themselves are in dispute?

After pointing out the conflict which existed in the authorities at the time of this decision as to whether appreciation or unearned increment should be included in arriving at that fair value upon which a rate of return is to be based, the Commission points out that, even assuming the applicant entitled thereto in a proper case, yet under

all the authorities an estimate of value based upon earnings or upon market value which is determined by the rate of return or earnings, when the reasonableness of the return or earnings is in question, must be rejected.

As to the uncertainty of determining with any accuracy the amount of gas which can be recovered from land which has not been fully developed, the Commission used the following language which is interesting in view of Davis' attempted calculation of the gas content of the probable acreage:

> "An undeveloped oil and gas leasehold cannot fairly be regarded as tangible property. It merely invests the lessee with authority to enter upon the land, prospect for and acquire and produce oil and gas. Since these substances are hidden in the depths of the earth they are no man's property until by drilling they are discovered and taken into possession, nor can we forecast what the result of this exploration will be or what any given area of land will produce, either in the way of volume of gas or quantity of oil. Hence the business of exploring for and producing oil and gas is in its very nature, experimental and speculative, hazardous and uncertain. It is a matter of general knowledge that the value of prospective oil and gas territory can only be ascertained with any degree of certainty and accuracy when fully developed. Promising territory may prove to be unproductive and large production may be found in 'wildcat' or unproven fields. Therefore, on account of the uncertain and speculative character of gas leaseholds, and in view of the fact that there is a constant shifting, especially in the unoperated acreage of the applicant, due to the acquisition of new territory and the abandonment of old territory, we would, indeed, be invading the realms of uncertainty of speculation and

> conjecture to place upon the applicant's acreage any such valuation for rate making purposes as that claimed for it by its witnesses."

In the same connection, pointing out the large amount of acreage which had been abandoned during the preceding two years, the Commission said:

> "The injustice to present consumers that would result from allowing as capital charge the valuation per acre placed upon applicant's leaseholds by its witnesses may be graphically illustrated by reference to its operating experience since December 31, 1916. During that period it has surrendered and abandoned over seventy thousand acres of its unoperated leaseholds. Assuming that 20% of this abandoned acreage has been valued at $100 per acre or an equivalent of $20 per acre for 100% thereof as claimed by applicant's witness, Wyer, applicant's capital would be depreciated by reason of the surrender of this acreage, to the extent of more than $1,400,000 in round figures, and in the meantime, during the same period, applicant's consumers would have been paying a rate to include a fair return and depreciation upon this immense amount of capital, which, in fact, had ceased to exist.

The conclusion of the Commission was to allow the gas company to include as a part of its capital investment the actual cost of obtaining the gas acreage it then held, and to earn a return thereon until such time as such charge should be amortized and wiped out as a capital charge by a fund to be created for the purpose, by setting aside each year a reasonable sum for amortizing its leasehold investment. It directed that in future all normal expense, both of acquiring and carrying gas acreage, should be charged to operating expense and not added to capital account.

It modified its holding in Case 585, in which it held that only one-half of the applicant's investment in unoperated acreage should be included in its capital account, to the extent of permitting its whole investment therein to be included, for the reason that it did not affirmatively appear "that under present conditions applicant's investment in operated acreage is more than will reasonably be required to meet its future demands"

Case No. 1251 (Bulletin 70) decided April 28, 1922, was in effect an application for rehearing of the two former cases, Nos. 585 and 845. It is not reported in any volume of reports. The Company adduced no new evidence on leasehold valuation and the Commission deemed the contention of leasehold appreciation "at least for the present abandoned"

In the second hearing of the same case (Bulletin 82, P. U. R. 1924 A 357) in August, 1923, only the initial investment in natural gas leases and leasehold estates was included in the rate base. However, it was held that the gas company should be allowed the market value of the gas at the city gate as just compensation for its gas used in serving the public by way of what is called "depletion", also that delay rentals and royalties should be credited against the depletion fund because charged to operating expenses.

It was from this decision of the Commission, allowing an increase in rates of about five cents per thousand cubic feet, that the protestants appealed to the Supreme Court of Appeals of the State. *City of Charleston* v. *Public Service Commission*, 95 W. Va. 91. In a carefully considered opinion by Judge Meredith the question of appreciated value of leaseholds was discussed, together with other questions involved in this suit, considered elsewhere.

While the Court held that the gas company was entitled to a fair return upon the present fair value of its property ***used and useful*** in the public service, to be ascertained

as of the time the service is rendered, and consequently to have included in its rate base "appreciation in the value of its leaseholds over investment cost", it further held that evidence of such appreciated value "to be competent must not be based upon, but must be independent of, the rates of return and earnings". While recognizing the rule laid down by this court that a utility is entitled to a fair return upon the present fair value of its property used and useful in the public service and that such value includes gas leaseholds, the court, at page 105 of the opinion, points out in plain terms that because of the many elements of uncertainty and speculation which necessarily enter into all opinions regarding the value of such gas leaseholds, it is only under *exceptional circumstances* that such appreciation can be allowed. Upon this point the court quoted with approval the following language from the opinion of Commissioner Wiles in Case No. 845, heretofore referred to:

> "Whatever may be the differences of opinion, as shown by court and commission decisions, as to the ascertainment of fair value for other property of a gas utility, the many elements of uncertainty and speculation that must necessarily enter into all opinions regarding the value of gas leaseholds are so obvious and well known as to render it manifestly unjust and unreasonable to place any value upon such property in excess of its actual cost."

Commenting upon this statement, the court said:

> "Unless the circumstances be exceptional, we think this is true, and particularly so in a case like the present where the applicant is permitted to charge the rentals and taxes necessary to carry the leaseholds as an operating expense."

Applying these principles, the court held the plaintiff's evidence of appreciation incompetent, denied the right of

the company to add to the book cost of the leaseholds the sum of $31,778,111.42 representing the appreciation in value claimed by it, and reversed the order of the Commission allowing an increase of five cents in rates.

An analysis of this opinion shows that the evidence introduced by the plaintiff in the present proceeding is not substantially different from that reviewed by the Supreme Court of Appeals of West Virginia in this case. Mr. Davis' testimony in case No. 1251, as summarized by Judge Meredith, shows:

> (a) That Davis divided the leasehold acreage, to which he attempted to assign value, into only two classes, namely, (1) operated and (2) unoperated but proven territory, aggregating from 100,000 to 150,000 acres (p. 107).
>
> (b) He excluded at this time from his estimates altogether about 650,000 acres which he himself then called "wildcat" territory. This necessarily includes much of the acreage which he subsequently classified in the present suit as "probable".
>
> (c) As to the content of this so-called gas reserve, he estimates that the supply in the present wells was, on September 30, 1921, 123 billion cubic feet, referring to the operated territory.
>
> (d) He estimated that there was a reserve in the unoperated but proven territory of 228 billion cubic feet, making a total of 351 billion cubic feet (p. 108).

From the foregoing it appears that the evidence before the State Court in this case was less speculative than the evidence now under consideration. This is so because Mr. Davis, who testified in both instances, confined his estimate of the gas content of plaintiff's leaseholds and the value

thereof in said Case No. 1251 to only "proven" territory, while in this suit he has enlarged the scope of his estimates to include what he now designates as "probable" territory. As stated by Commissioner Stathers, (R. 101):

> "While Mr. Davis has gone into his subject much more exhaustively than he did in Case No. 1251, yet his theories and methods are not substantially or materially different. As quoted above 'his estimates are mere estimates and nothing more'. The fullness and elaboration with which such estimates are presented now does not change their character. Of this we are convinced. **Nothing has been added by Mr. Davis which makes his recent estimates any more reliable, dependable or certain than those which have met with the disapproval of this Commission and the Supreme Court of Appeals.**
>
> *Accord, Re American Indian Oil & G. Co.* (Okla. Com.) P. U. R. 1924 E 114.

As pointed out by Chairman Stathers, the testimony of all plaintiff's witnesses who testified in the present proceeding, including both its engineer expert Uebelacker and its practical gas men, is based largely upon the testimony of Mr. Davis as to the gas contained in plaintiff's leaseholds (R. 102). Therefore, if the theories and methods adopted by Mr. Davis in the present proceedings are not substantially or materially different from those which he used as the basis of his testimony in Case No. 1251, they remain speculative and unreliable for reasons pointed out by the State Supreme Court of Appeals. It is as true now as it was then that "while his methods of estimating gas reserves may be the best methods known, his estimates are mere estimates and nothing more".

In spite of the elaborate argument of the plaintiff to the contrary, we submit that an examination of this evi-

dence will convince the Court of the accuracy of Judge Rose's summary of the efforts of the plaintiff in the present suit, where, after referring to the valuation of its leaseholds by the plaintiff and its adding to its capital the sum of $31,778,111.42 for leasehold appreciation, he said:

> "In substance the instant case resolves itself into an attempt to convince us that in this matter the Commission and the Court were wrong."
> (Rose Opinion, R. 1251.)

(3)—APPLICATION OF BOYLE'S LAW.

Mr. Davis appears to assume as infallible the application of the principle of Boyle's Law. He applies it not only to the "proven" acreage, but in some degree to the so-called "probable" territory, which he admits to be a speculative and untrustworthy undertaking, and claims two-thirds of the total estimated gas content for the "probable" territory.

Even as to the 69,000 acres of producing territory there must be a considerable degree of speculation, and as to the undeveloped and untested acreage, it can have no application, because there are no wells to show the rock pressure therein. As applied to natural gas deposits, the use of the law is of "comparatively recent origin", (Davis, R. 241) and untried significance. It is admittedly of value only where there is no encroachment by surrounding water (R. 241) a contingency not to be disregarded in territory not yet drilled. Gas confined in rock and sand formations three thousand feet beneath the surface of the ground is surrounded by conditions much more speculative and uncertain than the same gas in a laboratory container.

It is said that the principle has been approved by the United States Internal Revenue Department in tax investi-

gations. The necessities of those cases render some method of valuation imperative, but that department only applies the law to actually proven territory.

> "A proven area for the purposes of this statute shall be presumed to be that portion of the productive sand or zone or reservoir included in a square surface area of 160 acres having as its center the mouth of a well producing oil and or gas in commercial quantities. In other words, a producing well shall be presumed to prove that portion of a given sand, zone or reservoir which is included in an area of 160 acres of land, regardless of boundaries. The center of such square area shall be the mouth of the well, and its sides shall be parallel to the section lines established by the United States system of public land surveys in the district in which it is located. Where a district is not covered by the United States land surveys the sides of said area shall run north and south, east and west."
>
> Paragraph 2 of Article 220 (a) Regulations 62.

Mr. Davis attempts to apply this department regulation to areas which the department itself does not recognize as susceptible of valuation. Indeed, he admits that even as to proven territory the Internal Revenue Department had reduced his estimates ten per cent. (R. 241.)

(4)—FUGITIVE CHARACTER OF GAS IN THE GROUND.

The strongest reason for exercising the strictest caution in attempting to estimate the volume of gas in the ground is the inherent quality of the gas itself. Unlike mineral substances such as iron and coal which occupy a fixed area, natural gas is essentially of a migratory and fugitive character. Following the course of least resistance it flows

from one point to another, and, like the animals to which it has often been likened, is in its nature *ferae naturae*, the property of one man today and another tomorrow.

"Until reduced to possession by confinement, natural gas, it is said, though somewhat inaccurately, partakes of the nature of *ferae naturae*. It is not the subject of ownership till brought to the surface and confined."

Suttle v. *Hope Natural Gas Co.*, 82 W. Va. 729, 738, 97 S. E. 433.

"It is apparent from this history of the nature and properties of natural gas, that it partakes more nearly of the character of the elements, air and water, than it does of those things which are the subject of absolute property. It is more volatile than the air, and when tapped in the earth it escapes more readily. When the supply is withdrawn from one place, it flows of its own accord from other points and replaces that which has been withdrawn. What distance or from what source it comes is the subject of conjecture only. The well or means of escape may be on one farm or in one county, and the reservoir or source of supply may be under other farms or in other counties more or less distant. Like water percolating beneath the surface, it may by sinking a well, or otherwise, be appropriated for the use of one person on his farm, while the supply may come from an adjoining or many distant farms. The right of appropriation is so absolute in the case of water flowing underground, that if the owner of land in digging a well or cellar or working a mine on his own premises cuts off the water, which by percolation supplies his neighbor's well, and thereby diverts it into his own or drains the well of

his neighbor, the latter is without remedy; it is *damnum absque injuria*, if not negligently or maliciously done. (Brown v. Illins, 25 Conn. 594; S. C. 27 Id. 94; Emporia v. Soden, 25 Kan. 608.)"

Wood County Petroleum Co. v. W. Va. Transportation Co., 28 W. Va. 210.

"Men may divide the moon by imaginary lines, but equity will not enforce their contract. They may divide the water in a well or in a brook, or the game in the forest or the fishes in the sea, but equity will afford them no such relief. 'Oil and natural gas are minerals, in the view of the law; but, because of their peculiar attributes, they, as the subject of property, differ from other minerals. * * * Out of possession there is no property in them. * * * They are not capable of distinct ownership in place, owing to their liability to escape from the place where they may be temporarily confined without necessarily any interference on the part of the owner of the soil, or others claiming through him, under whose land they may be found. Like water, they are not the subject of property, except in actual occupancy, and a grant of them passes nothing for which ejectment will lie. * * * Oil and gas cannot, while in the ground, like the solid minerals, be the subject of an estate distinct from that in the soil.' Barringer & A. Mines & M. pp. 30, 31. A grant to the oil and gas passes nothing for which ejectment will lie. Dark v. Johnson, 55 Pa. St. 164. So the reservation of the oil and gas is not of the oil and gas in the ground but of the oil and gas the grantor or his assigns may find and reduce to possession, with the exclusive right to search therefor. *Natural Gas is incapable of being absolute property, and is the subject of qualified*

property only. Wood County Petroleum Co. v. West Virginia Transp. Co., 28 W. Va. 210. 'A grant or reservation of oil or gas in certain land passes an incorporeal right only. This arises, as has been above explained, from the nature of oil and gas, which is such that a corporeal interest in them in place cannot be created'. Barringer & A. Mines & M., p. 78. 'There can be no property in rock or mineral oil, nor can title thereto be devested or acquired, until it has been taken from the earth.' Shepherd v. Oil Co., 38 Hun. 37. Oil and gas grants and reservations are incorporeal hereditaments, which are entire and indivisible at law though they may be made divisible by the terms of the grant. *Funk v. Halderman*, 53 Pa. St. 229."

Hall v. Vernon, 47 W. Va. 295, 34 S. E. 764.

Gas in the ground can always be drained from one leasehold by producers operating nearby lands. In fact the drainage may be accomplished by wells at a great distance. It follows, therefore, that the gas which today underlies the leases of the plaintiff may be diverted to others by the simple drilling of wells by other producers. Plaintiff insists that its particular holdings are compact and well protected. In a relative sense that appears to be true, but the naive method employed by Mr. Davis of simply totalling the area of lands held by the plaintiff in territory said by him to be "probable" altogether leaves out of account whether the component portions making up that total are well or insufficiently protected. The psychological value of a mental picture of two large blocks of leases, one of 130,000 acres of "proven" lands and another of 126,000 acres of "probable" lands was by no means overlooked by the plaintiff's witnesses.

The plaintiff omits to point out that all the while its leases are undrilled the company is at the mercy of competi-

tors and others who may at any moment contract with its lessors and thereby deprive the company of its holdings at the end of the stipulated term of its leases unless drilling is done successfully by it before the term expires. This is the common practice of "top-leasing". The effect of a strong competitor in the field was strikingly indicated by Mr. Davidson's twenty per cent reduction of his valuation estimate upon the entrance of the Hope Natural Gas Company into Southern West Virginia (R. 317).

The speculative character of the unoperated lands is reflected in the fluctuations of plaintiff's leaseholds. In 1917, when its case No. 585 was before the Commission, plaintiff controlled 770,034 acres of unoperated leases and 52,349 acres of producing leases, acreages not disproportionate to plaintiff's present holdings. Yet, during the period 1917-1923 the plaintiff abandoned 391,672 acres of leases (Jirgal Ex. No. 3 R. 1096). In other words, during that period approximately 50 per cent of its holdings were dropped either because they were deemed so worthless that it was considered not worthwhile to carry them longer, or they were lost to some competitor who secured the renewals at the expiration of plaintiff's leases.

(5)—LEASEHOLD RIGHTS DISCUSSED:

The quantity of gas lands owned by the plaintiff in fee is so negligible that neither the plaintiff's counsel nor any court or commission has ever attempted to separate the fee lands from the leaseholds. Practically all of its gas rights are held under leases, the character of which we have previously outlined. The fact that plaintiff holds leases only is a material circumstance in this case, one which has been deemed of importance by Commissioner Stathers, by Judge Rose and Judge Hickenlooper in the Kentucky case.

The Commission, not having the leases before it, was forced to call upon its general knowledge of such instru-

ments. Knowing that gas leases are frequently burdened with conditions and obligations, such as free gas to the lessor, the duty to drill a certain number of wells, forfeiture provisions, etc. (R. 109), Chairman Stathers very properly observed that it is upon these undisclosed terms and provisions that the value of the leases may depend (R. 111). Wherefore, he said that evidence as to the volume of the "gas reserve" or "gas content" without regard to the character of the leasehold rights could not be received upon the value of the leaseholds. He made the following reference to the legal effect of a gas lease in West Virginia:

> "Unless title to the gas has passed to the Gas Company, under the 'usual lease', it has no title to such gas and this Commission can not place a value upon the gas or gas acreage as such. The record shows that the Gas Company had 'leases or deeds in fee' for its gas producing territory as of December 31, 1923, which leases were 'alive at that time'. Such leases or paper pass no title in the gas to the lessee. The title to the gas remains in the lessor and continues as his property until it is extracted, when title vests in the lessee. The only right given to the Gas Company under its lease is the right to explore for oil and gas and to produce them when found. Always has this been the law in West Virginia, a clear expression of which is:
>
> > 'The ordinary oil and gas lease giving the lessee for a term of years the right to mine and operate for oil and gas is not a sale of the oil and gas in place and the lessee has no vested interest therein until it is discovered, but when found, the right to produce becomes a vested right and when extracted the title vests in the lessee, and the consideration for royalty paid

> for the privilege of search and production is returned for the leased premises.'
>
> *Hadley* v. *Hoopengarner*, 60 W. Va. 626."
>
> (Opinion of Commission, R. 109-110.)

This is well settled law in West Virginia, Pennsylvania and other states.

> *Smith* v. *Root*, 66 W. Va. 633;
> *Toothman* v. *Courtney*, 62 W. Va. 167;
> *Hall* v. *Vernon*, 47 W. Va. 295;
> *Steelsmith* v. *Gartlan*, 45 W. Va. 27;
> *City of Erie* v. *Pub. Ser. Com.*, 278 Pa. 512; 123 Atl. 471, 474;
> *Pennsylvania* v. *West Virginia*, 262 U. S. 553, at p. 586.

It has been held that these decisions constitute a rule of property.

> *City of Erie* v. *Pub. Ser. Com.*, *Supra*.

We understand that the rule in the Federal Courts is that such decisions involving the rights of property "constitute rules of property and must be accepted and applied in passing on complainant's rights."

> *Guffey* v. *Smith*, 237 U. S. 101.

Judge Hickenlooper accepted this view:

> "Another objection to applying the basis adopted by Mr. Uebelacker is that it presupposes ownership by the complainants of gas in the ground prior to recovery. Practically all of this class of property is held by the complainant under gas leases which convey no interest in the real estate, but give only

> the right to explore for and extract natural gas. Not only are percolating waters and oil and unrecovered gas in the ground not the subject of ownership until recovered, but, if the subject of ownership, such gas is the property yof the owner of the fee until recovered. Not only has such gas no value unrecovered in the ground, but such value as it might have would seem to be the property of the lessor."
>
> *United Fuel Gas Co.* v. *Railroad Commission*, 13 Fed. (2d) 510, 519.

We think that the real significance of the expressions of the courts which have considered this matter is that it must not be overlooked that plaintiff does not own and may never own the gas underlying the thousands of acres of undeveloped leases held by it. The title to the gas, in so far as there may be ownership of so shifting and uncertain a substance as natural gas, remains in the lessors. They pay the property taxes thereon. The plaintiff owns the lease, the right to explore, a right subject to loss upon the happening of any one of many contingencies, some of which it is beyond human power to forestall. It necessarily follows, therefore, that the value of the gas content, even though it could be accurately estimated, is not the equivalent of the value of the intangible rights of the plaintiff.

There is no certainty that the company will be able to bring to the surface the estimated gas now underground, even if the estimated quantity be approximately correct. To include in the rate base of this company the estimated supply of gas appraised on any of the bases proposed by plaintiff is equivalent to charging the public with a return on property not owned by the plaintiff and which is illusory, intangible and fugitive in character. Conceding, for the purpose of the argument, the utmost which plaintiff can claim, **the problem is to determine the**

present value of the plaintiff's right to extract the gas under its leases and not to find the value of an estimated and uncertain volume of gas, the possession and ownership of which can be secured only by drilling and bringing it to the surface.

> "The value of gas lands for rate making purposes is not the sale price of a cubic foot of gas, as applied to the supposed quantity in a given field, but the reasonable market value of the whole tract or tracts from which the gas is produced."
>
> *American Indian Oil & Gas Co.* v. *Poteau*, (Okla.) 235 P. 906, P. U. R. 1926 A 236, Citing *City of Erie* v. *Public Service Com.*, 278 Pa. 512, 123 Atl. 471, P. U. R. 1924 D. 89.

Plaintiff no doubt will reply that it was for the purpose of fixing the value of the leases as such that it introduced its so-called practical gas men, whose testimony we have outlined briefly. Subsequently we shall attempt to point out the inherent defects in their testimony.

(6)—DAVIS' VALUATION OF ESTIMATED GAS CONTENT:

By methods already explained, Mr. Davis estimated the amount of gas which could be delivered from the gas reserves during the next eighteen years at 663,700,000,000 cubic feet. He assumed that *all of this gas* could be sold to steel mills in Pittsburgh, where there would be a large demand for natural gas in the place of soft coal, which it is claimed plaintiff could supply were it in position to abandon its retail consumers and deliver all of its gas to the steel mills there. He next made a comparison between the cost of manufacturing steel by the use of coal and by the use of natural gas, and upon the basis of that comparison gave it as his opinion that if the plaintiff could deliver its entire output in Pittsburgh it

would be worth not less than 35 cents per M cubic feet. (R. 244.) He next accepted the cost of transporting gas from Cedarville on the state line to Pittsburgh ($0.0526 per M cubic feet) and line loss ($0.0175 per M cubic feet) as estimated by Mr. Uebelacker. (A pure speculation as plaintiff owns no pipe lines in Pennsylvania.) Deducting the sum of these items ($0.0701) from the estimated Pittsburgh price of 35 cents per M cubic feet, he arrived at a net value of the gas at Cedarville of 27.99 cents per M cubic feet. (R. 970.)

He then estimated the probable sales of gas in cubic feet for the years 1924 to 1941, inclusive, and the revenue therefrom, which he reduced to a unit basis, the unit being one thousand cubic feet. The cost of production and transportation to Cedarville was fixed at 8 cents per M cubic feet, this figure being based upon the alleged cost of $0.07989 for the year 1923. He added ¼ of a cent each year to represent the supposed rising trend in production costs. Deducting this production cost and the transportation cost and line loss from Cedarville he arrived at a sum which he termed the net earnings per M cubic feet for each year of the eighteen-year period, ranging from 16.845c for 1924 to 14.247c for 1941. Applying this unit of net earnings to the total sales, he determined the annual net earnings in dollars. To this total he applied a compound discount factor based upon 8 per cent value of money. By this method he fixed the present worth of the net earnings at $56,582,799.00. As plaintiff's investment in wells and pipe lines were in part responsible for this present worth of earnings, he deducted the depreciated reproduction value of those items, as estimated by Mr. Uebelacker, ($19,723,409), and the estimated federal taxes, amounting to $4,401,261.76, and fixed the present value of the gas rights alone at $32,458,129.17. (Davis "Exhibit Z", R. 971-3.)

Aside from the numerous assumptions upon which this method of valuation is based, it is subject to the funda-

mental objection that it is premised upon the estimated cost of the next available substitute fuel, soft coal, or artificial gas produced from soft coal. He thus introduces into the problem the market value theory of valuing a public utility property. It is another illustration of the vicious circle of pyramiding of prices based upon corresponding increases in value of available substitutes. Plaintiff now asks that the price of its gas be increased because of the current price of soft coal and producer gas. If its demands be allowed, the producer of the substitute fuel, artificial or producer gas, in turn increases his prices because of the market price of gas as an available substitute, and so on until the market will bear no more.

Similar theories criticized in *Re Western States Gas & Electric Co.* (Cal.) P. U. R. 1924 D 681.

As pointed out by Mr. Hagenah:

> "This same theory was at one time advanced by the owners of other natural resources devoted to public service, notably water power companies, railroad facilities, etc. It is the settled practice of utility commissions in rate inquiries not to consider the earning power of the utility as the basis on which to determine the value of that property for the use of which reasonable rates are to be prescribed. To adopt the earning power as the measure of value of a natural monopoly on which a reasonable return may be earned is but to reason in a circle, a fallacy which has long been recognized by regulatory bodies and rejected by state and Federal courts and the United States Supreme Court. Railroads have never received official sanction for rates based on the cost of performing the same service with a substitute facility, or on the basis of 'what the traffic would bear.' Owners of water power devoted to public utility service have never been permitted to capitalize their natural

resources on the basis of the total savings in such business as compared with performing the same service with steam generation facilities. There is no process of reasoning by which owners of natural gas deposits can capitalize the advantages which such natural resources provide as compared with the cost of artificial gas."

(Hagenah "Exhibit No. 2", R. 1179.)

A further objection to Mr. Davis' application of the exchange theory to natural gas is that in founding its value upon artificial gas, he employs for his comparison a commodity the market price of which in the Pittsburgh industrial district is necessarily dependent in large part upon the regulated price of natural gas in the same territory. To this extent Mr. Davis disregards the decisions of practically all courts which have dealt with the question.

State ex rel. Springfield Gas & Electric Co., (Ill. Sup. Ct.) P. U. R. 1920 C. 640;

People ex rel. Kings Lighting Co. v. Willcox, 210 N. Y. 479;

Fuhrmann v. The Cataract Power & Conduit Co., (N. Y. P. S. C. 2d Dist.) Commission Leaflets 18, p. 1015;

Simpson v. Shepard, 230 U. S. 454;

Logan v. Bismarck Water Co. (N. D.) P. U. R. 1923 B at 508.

We submit the following statement of Mr. Hagenah is sound:

"In a natural gas rate case exchange value cannot logically be a valuation factor, since exchange value depends upon the net income, both present and prospective, and that income in turn depends on the rate to be charged, the amount of gas in the reserve and the cost of its delivery. Exchange value

being dependent upon the rate, it follows that such relationship cannot be the subject of inquiry in a rate case. To base the rate upon the exchange value in this case would be merely to continue the assumed rate, and this condition would obtain so long as such rate was not disturbed. If a change in rates affects the income, it correspondingly affects the exchange value, and if the rate can be arbitrarily fixed by the cost of supplying a competitive and substitute service, the exchange value is thereby also fixed. Courts have stated in language that admits of no misunderstanding that exchange value is not a factor in arriving at the fair value of public utility property for rate purposes. In disregarding judicial interpretation on this point, Mr. Davis assumes the correctness of one of the main factors in issue in this case, namely, the rate."

(Hagenah, "Exhibit No. 2", R. 1178-79.)

Should we accept, for the purpose of the argument the valuation theory of Mr. Davis, his statements and conclusions are not supported by data or facts. The costs of artificial gas and soft coal used by him are predicated upon the market price of coal as of December 31, 1923, shown to be approximately $4.00 per ton delivered in Pittsburgh. Mr. Hagenah's "Exhibit No. 3" (R. 1194) is a convincing refutation of any conclusion based upon an assumed price of coal over an extended period of time. The assumption that the market price of coal will be stabilized on the price level of December 31, 1923, is not supported by the history of the bituminous coal industry, the conditions of supply and demand prevailing at that date, nor by the economic forces operating in that business. Recent improved methods of production and distribution of coal necessarily presage reduced operating costs and a corresponding downward trend in prices. The factors contributing to this downward movement, over-develop-

ment, competition in non-union fields, cheaper freight rates, improved transportation facilities, reduced mining costs, competitive fuels, are all exhaustively reviewed in Mr. Hagenah's Exhibit (R. 1194-1209), consideration of which sustains the conclusion reached by him (R. 1208) that the valuation of Mr. Davis founded upon an assumed continuance of the price of coal as of December 31, 1923, is clearly excessive.

The "advantageous" market referred to by Mr. Davis, the steel mills of Pittsburgh, is no more stable than the price of bituminous coal. No industry in the United States is subject to more frequent and wider fluctuations in the demand for its product than is the iron and steel industry. (See diagram, R. 1181). To use Mr. Carnegie's phrase, it is always either "prince or pauper". The maximum demands of the iron and steel business in periods of great prosperity would far exceed the capacity of the plaintiff, but would fall below it in the cycles of depression. **The only stable market open to the plaintiff is the market it now supplies, its public service consumers.** The broader public interest requires that the wholesale industrial consumption give way to the domestic market. It is in distinct recognition of this fact that the steel industry has definitely turned away from natural gas as a fuel and now relies almost wholly upon coal for its fuel supply. This Mr. Davis admits. (R. 964-5.) That the plaintiff, if it could legally do so, would abandon its present stable and safe public service market for the uncertainties of the steel industry is unbelievable. (Hagenah, R. 1180-1182.)

Mr. Davis' theory further assumes the abandonment of that part of plaintiff's present physical property which would not be used if the entire output of gas were delivered to the Pittsburgh market; nevertheless, he makes no allowance for the losses growing out of such abandon-

ment, appraised by Mr. Uebelacker in excess of $12,000,000. (R. 1187.)

Going a step further, we find that Mr. Uebelacker has estimated the cost of delivering the gas from the field to Cedarville at 17.552 cents per M cubic feet. Deducting this amount from the Cedarville price of 27.99 cents, the value of the gas in the ground is 10.438 cents. Mr. Uebelacker has made a study, which he considers exhaustive, of the value of gas in the ground, and he finds that this value is five cents per thousand cubic feet. Mr. Davis, however, in order to justify his value of the gas rights, refutes Mr. Uebelacker's estimate of the fair market value of gas in the ground, and states that it should be ten cents instead of five cents.

With a few contracts which he said were representative of the value of gas in the ground, Mr. Uebelacker could not arrive at a value of the gas in the ground higher than five cents per thousand, and yet Mr. Davis, by taking a far away market, reaches a value over twice as high as that of Mr. Uebelacker. Either one or the other of these two gentlemen has made an erroneous estimate of the value of gas in the ground, otherwise the mere delivery of such gas in Pittsburgh has added an additional five cents to its value in the ground. Judge Rose called attention to the remarkable closeness of the answers reached by these two experts to the problem of the value of the plaintiff's gas reserves, notwithstanding one used a price of 30 cents per M c. f. and the other 35 cents, for the same quantity of gas delivered at the same point:

> "It will be recalled that Mr. Davis, although he dealt with the problem in a radically different way, arrived at almost precisely the same valuation. His figures were $32,458,129.17. The difference between him and Mr. Uebelacker is only $726,870 or less than 2½ per cent. This agreement would be very impressive, were it not that each bases his figuring

upon what he assumes is the price which can be obtained for gas at Pittsburgh. Unless one or the other or both of the methods used are fallacious, a concurrence of result would have been impossible unless they had been at one as to the one factor which was common to both. Now it is a striking illustration of the uncertainty of such calculations as they have severally made that, instead of agreeing as to the Pittsburgh price, Mr. Davis assumed that it was and would be 35 cents per M c. f., while Mr. Uelselacker estimated it at 30 cents. This price is to be paid at intervals over eighteen years, and Mr. Davis has figured for us that every dollar so received has a present worth of 61.64 cents, so that an average difference of 3.082 cents on the present worth of each thousand feet of plaintiff's reserves or for the 663,700,000 M c. f. of $20,455,-244. As Mr. Uelselacker based his calculation upon a price of 30 cents at Pittsburgh, his totals should have been that much less than those of Mr. Davis, who more optimistically assumed that 35 cents a thousand could be obtained at that point for it. We have seen that in fact they were $7,26,870 more."

(R. 1260.)

As already stated, Mr. Uelselacker assumes a value for gas delivered at Cedarville of 22.812 cents per thousand cubic feet, while Mr. Davis says that the value at Cedarville, on the basis of 35-cent gas at Pittsburgh, would be 37.99 cents. There is a difference, therefore, of over five cents in the value assumed to apply for gas delivered at Cedarville.

If Mr. Uelselacker is correct as to the value of plaintiff's gas at Cedarville, then the substitution of that price in

Mr. Davis' calculation of the value of the gas rights results in a considerably less value being shown. To show this we have modified Mr. Davis' calculation as follows:

Average Net Value per M cubic feet on basis of $91,792,894.00 Income to be realized before amortization from sales of 674.7 billion cubic feet during years 1924-1941 inclusive, in cents	13.605
Deduct—Excessive market value shown to have been used by Mr. Davis	5.00
Average Net Value after Adjustment	8.605
Expected Net Income before Amortization on basis of average net income of 8.605 cents per M cubic feet to be realized from sales of 674.7 billion cubic feet	$58,057,887.77
Compound Discount Factor necessary to Convert to Present Worth	61.64%
Present Worth of above Expected Net Income	$35,787,927.21
12½% of Earnings, Income Tax ($58,057,887.77—$35,787,927.21)	$ 2,783,745.07
Market Value of Gas Content	$33,004,182.14
Deduct—Depreciated Value of Property included other than natural gas fee and leasehold property necessary to deliver gas to market	$19,723,409.00
Market Value of Natural Gas Fee and Leasehold Property	$13,280,773.14

(7)—CRITICISM OF UEBELACKER'S VALUATION OF GAS CONTENT:

Since Mr. Uebelacker made no independent estimate of the gas content, his valuation of plaintiff's gas rights rests wholly upon the Davis estimates. We have outlined briefly his methods, and have pointed out objections thereto. It will be recalled that in addition to assuming the presence of 603.1 billion cubic feet of gas in plaintiff's leaseholds, Uebelacker undertook from illustrative sales contracts to determine (a) the prevailing market price, and (b) the total cost to the plaintiff of producing an equivalent supply of gas under delivery conditions similar to those of said sales contracts, including depreciation, amortization and a fair return.

This theory *necessarily contemplates the consideration of a sufficient number of contracts to establish beyond a reasonable doubt the fair market value of the gas*, also an accurate analysis of the production and maintenance costs of the plaintiff. The fact is that Mr. Uebelacker referred to only five sales contracts, the contracts not appearing in evidence and the quantity of gas embraced therein not appearing, and to a hypothetical sales price in the Pittsburgh industrial market. The prices so shown were considered illustrative and probative of the fair market value of gas in plaintiff's fields. Mr. Uebelacker next estimated the cost of production to the plaintiff of supplying an amount of gas equivalent to that required by these contracts. In the case of the International Nickel Company, South Penn Oil Company, Owens Bottle Company and Falling Rock Cannel Coal Company, he fixed the production cost at $0.05431 per M cubic feet. This cost included operating expense, royalties, general expense, depletion and a return of 8% on the deteriorated value of the wells and well lines as of December 31, 1923. (R. 5236.) The estimated unit cost of supplying the Pittsburg industrial market and the Hope Natural Gas Company at

Cedarville was arrived at similarly, but involved much more elaborate estimations of tranportation costs and line loss to Cedarville and from the latter point to Pittsburgh over lines not in existence. The result of these calculations is fully shown in the following table:

	Contract Price	*Production Cost*	*Value per M Cubic Feet of Gas in Ground*
Purchase in field by Owens Bottle Works, Charleston, W Va	$0.10	$0.05431	$0.04569
Purchase in field by International Nickel Company, Huntington, W Va	0.17	0.05431	0.11569
Delivery at Pittsburgh Industrial District	0.30	0.22812	0.07188
Purchase in field by South Penn Oil Company	0.08	0.05431	0.02569
Delivery to Hope Natural Gas Company and West Virginia Central Gas Company, at Cedarville by United Fuel Gas Co	0.2266	0.17552	0.05108
Purchase of "Dry" (gas) in field by United Fuel Gas Co Co from Falling Rock Cannel Coal Co	0.085	0.05431	0.03069

"Based upon a review of these results," Uebelacker arrived at an average value of plaintiff's gas in the ground of five cents per thousand cubic feet, which he applied to Mr Davis' estimate of gas content. He made no attempt to reduce his estimates to present values, but by the simple method of multiplication he fixed the value of the

"proven" at $12,445,000 and the "probable" at $20,730,000. Neither Mr. Uebelacker nor Mr. Davis consider the fact that in the year 1923 plaintiff purchased 9,669,753,000 cubic feet of gas at an average price of 0.4 cents ("Jirgal Ex. No. 5," R. 1137.)

Admitted facts challenge the trustworthiness of Mr. Uebelacker's figures. The plaintiff delivers gas daily in Huntington, West Virginia, at 21 cents per M cubic feet, yet the fair market price for gas delivered there, according to Uebelacker, is 20 cents (R. 526), the amount fixed by the contract of the International Nickel Company. *In other words, plaintiff is attempting to justify a rate increase based upon the alleged value of its gas in the ground, although such alleged value is predicated upon a selling price less than that permitted under existing rates.* If the independent producer which supplies the International Nickel Company earns a profit of 11.569 cents per M cubic feet, it is doubtless largely due to the fact that plaintiff's price of 21 cents, now permitted by the Commission, establishes the standard in that locality.

We have fully discussed the Pittsburgh industrial market in our review of Mr. Davis' valuation methods, and shall say no more concerning it. Plaintiff's price to the Hope Natural Gas Company and the Pittsburgh and West Virginia Gas Company, and its use of that price as a basis for rate increases are interesting. Public utilities purchasing gas from the plaintiff include the cost of gas purchased in their operating expenses, upon which the rates to their own customers are in part predicated. The result is a striking example of the pyramiding of rates. While the buyer builds its rates upon the cost of its supply, the seller, also a public utility, builds the rates to its patrons upon the price of that gas which it is able to secure from other utilities purchasing from it. Mr. Hagenah correctly

appraised the situation in the following observation relating to Mr. Davis' testimony as to the wide market for plaintiff's gas in other states:

> "I have examined the report of Mr. Davis in which he says that as an alternative to selling gas in the Pittsburgh district his valuation is sustained by the further fact that this company now has transmission mains connecting it with many other cities where it is possible to obtain higher rates for gas, and that to the extent of these other communities or markets being willing to pay a higher price for gas, the value being sustained thereon should be included in the rate base, and serve as a justification for increased charges against the cities and consumers in West Virginia. That is another form of exchange theory. It merely amounts to this. If in Pennsylvania, Ohio and Kentucky, where the natural gas resources are not so well fixed and extensive as they are in West Virginia, they are, because of the higher cost of fuel, willing to pay for this rich product a higher price as determined by their next available sustitute measure, the saving between the price which they are willing to pay and which the community here has been paying may be capitalized against this public. That has operated in this form. When the cities in Ohio and adjoining states pay a higher rate, the gas companies ask the people of this community to pay higher rates or the gas will be piped out of the State of West Virginia. When the cities in West Virginia pay a higher rate the gas companies say to the cities in other states: 'If the gas companies can sell their product at home there is no incentive for piping the gas a long distance, and they must have the higher rates at distant points.' When these rates are granted, the statement is made to

other cities, 'Unless you pay as high a rate as these cities are paying we will sell our gas where we can get the largest price.' This practice has resulted in a vicious circle, and Mr. Davis is capitalizing the natural gas reserves on the theory that that vicious circle constitutes an economic justification and support for the value which he has found, and using that theory as measuring the saving in this field."

(Hagenah, R. 433-434.)

The Court already may have noted the variance between the allegd market price of gas in the fields and in distant markets. Local buyers pay from 8 cents to 10 cents per M cubic feet. It appears that the field price, or the price at the point of production, yields a value for gas in the ground much lower than the average of 5 cents estimated by Mr. Uebelacker. Even considering the fact that in each instance the production costs *of the plaintiff* have been used rather than those of the particular seller who was a party to the contract in question, the value of the gas in the ground, as measured by the contracts for nearby delivery, is more nearly 3 cents per M cubic feet than the 5-cent average of Mr. Uebelacker. Other elements than mere transportation cost enter into the value of natural gas at points distant from the producing field. The only contracts of those listed by Mr. Uebelacker which in any degree indicate the value of plaintiff's gas are those for field delievery, and which indicate a value in the ground of about three cents per thousand cubic feet.

(a)—*Gas Purchased Theory of Judge Rose.*

Mr. Hagenah, in his "Exhibit No. 4" (R. 1209-1216) points out several objections to Mr. Uebelacker's methods. We will review only one. Mr. Uebelacker allowed a return of 8 per cent upon the value of the gas content as

estimated by him in addition to an amortization charge. This is incorrect. To apply his theory properly he should have added to the operating expenses of the plaintiff the sum of 5 cents for each thousand cubic feet withdrawn and allowed no further charge for return on investment in the leases or for their amortization. There can be no charge in the operating expenses for return or amortization on the gas in the field after that drawn out has been charged at its fair market value. If the gas taken out is valued at 5 cents per thousand cubic feet, that amount, plus the direct operating expenses, must be inclusive of all charges pertaining thereto. The owner cannot sell his product at the market price and then seek to obtain in addition another charge to cover the return on his investment and amortization. This is precisely the idea in the following suggestion of Judge Rose:

> "If it bought from some one else the gas which it distributes in Charleston, Huntington, and other West Virginia places, what it paid to the seller would form a part of its operating costs, at least whenever it and the seller had no connection with each other and dealt at arm's length. In that event, the value of the gas reserves owned by the concern which sold the plaintiff gas would have nothing to do with the value of the latter's property, used and useful in the public service.
>
> "Is it clear that the situation in this respect is different merely because the plaintiff owns the gas it furnishes? If it is not, we are not here concerned with the valuation which may be placed upon plaintiff's gas reserves or upon any important part of them. Upon the assumption suggested, commissions and courts, when called upon to deal with the rate which the plaintiff is entitled to charge, would, as in other like cases, have to determine the value of the plaintiff's tangible

property used in the public service, including therewith a sufficient allowance for working capital and going concern value. The total of these items would represent all upon which it would be entitled to earn a return and all upon which any allowance for depreciation and amortization should be made. Having determined what the plaintiff's gross income is, precisely as they would in any event have to determine it, they would add the fair market value of the gas it delivers to its public service customers to what they had ascertained to be its outlay for operating expenses and taxes. It would then be necessary to determine whether such net income as so calculated, after making proper allowance out of it for depreciation and amortization, was sufficient to yield plaintiff a fair return upon the value of its property. However plausible this view may be, it does not seem to have occurred to any of the parties to the cause nor to any of the learned counsel engaged in it. So far as we can recall, no reference has ever been made to it by the Commission nor by the Supreme Court of Appeals of the state. The presumption against it is therefore strong, but on the other hand, it has something of apparent reasonableness about it, for West Virginia cannot require plaintiff to sell its gas in the state if it can get a higher price elsewhere. *Pennsylvania v. West Virginia*, 262 U. S. 553, 559, 43 S. Ct. 658, 67 L. Ed. 1117, 32 A. L. R. 900. If it be sound, there will be no need to seek a solution of a number of problems which are difficult or impossible to solve. At present we do no more than propound it, so that in the further proceedings in the cause, it may be given such consideration as it may merit, if indeed it be worth any at all."

United Fuel Gas Co. v. Public Service Commission, 14 Fed. (2d) 209, R. 1265.

Mr. Hagenah made use of this very principle in his Exhibits No. 6 and No. 6-A. (R. 1222.) In the statement there shown there is substituted for all of the company's leasehold expenses a value of 5 cents per thousand cubic feet for the gas taken out of its producing territory during the year 1923. In other words, the gas which was reduced to possession during that year has been valued at the high fair market price assumed by Mr. Uebelacker, and included as an operating cost. All leasehold value is then, of course, eliminated from the rate base. Here all speculation as to whether the gas will be produced and delivered is removed because the actual amount of gas which the applicant reduced to possession during that year is known. As already pointed out, it is the actual reducing to possession of a commodity which is necessary to the application of any fair market price. This statement of Mr. Hagenah's shows that by using even the high fair market price of Mr. Uebelacker, the company in the year 1923 earned 19.38 per cent for return, depreciation and amortization on that part of its investment (reproduction cost new less depreciation basis), which is exclusive of the leaseholds. Even if, as contended by the plaintiff, such fair market price is exclusive of the gasoline extraction privilege, there would still be available for return, depreciation and amortization on the cost of reproduction new less depreciation, an amount equivalent to over 15%. Nothing in the record supports the conclusion that the fair market price is as high as 5 cents per thousand cubic feet, and there *is* evidence in the record, as already shown (R. 408), which shows that excluding the gasoline extraction privilege, the fair market value of the gas is much less than 5 cents per thousand cubic feet—certainly not more than 3 cents per thousand cubic feet.

The protestants, therefore, contend that the most practical application of Mr. Uebelacker's theory is to include in the operating expenses, 5 cents for each thousand cubic

feet of gas which the applicant has reduced to possession in any given period, and to deduct from such operating expenses any expenditures connected with the source of supply, that is, the leaseholds. This Mr. Hagenah has very effectively done in his statement at page 1222 of the Record.

In summary of Mr. Uebelacker's theory, the following criticisms are pertinent:

(a) That he assumed that all of the recoverable gas content estimated by Mr. Davis would ultimately be delivered to the consumers, while there is no certainty or even probability that such will be the case.

(b) That he assumed that the fair market value of the gas in the ground was 5 cents per thousand cubic feet, notwithstanding it appears that large quantities of gas are at present being purchased by the plaintiff and others at prices indicating a value in the ground considerably less than 5 cents.

(c) That he gave no consideration whatever to the fact that the seller of the gas must deduct from his rate of 5 cents per thousand for gas in the ground, his delay rentals, leasehold expenses, federal taxes and depletion.

(d) That he assumed that a present fair market value of 5 cents per thousand today, spread over the deliveries in the next eighteen years with payments being made at 5 cents during the entire period, should not be reduced to present worth — Mr. Davis shows that the present worth of a future expected income necessary to provide an 8 per cent return in the interim, results in a present price which is only 61.64 per cent of the actual price, in other words, that a fair price of 5 cents paid for gas delivered over 18 years is equivalent to a present price of substantially 3 cents per thousand cubic feet.

(e) That he used throughout his calculations the lifting costs of the plaintiff instead of the lifting costs of the sellers of the gas.

(f) If the value of the gas reduced to possession in 1923 is included in the operating expenses at Uebelacker's figure of 5 cents per M cubic feet, the plaintiff still earns an ample return on the fair value of its property exclusive of leaseholds.

(g) The estimated Pittsburgh price takes no account whatever of the inevitable result of dumping into that market approximately forty billion cubic feet of gas per year. If such a market value exists there now as is testified by Mr. Uebelacker, it is because of the scarcity of gas there. If such an unregulated market were suddenly flooded with gas, it is manifest that the price would decline. This criticism applies equally to the valuation theories of Mr. Davis.

Taking into account certain of the foregoing criticisms, we have modified Mr. Uebelacker's calculations as follows:

663 billion cubic feet at 3 cents	$19,890,000
Present worth of a future expected income of 3 cents per M cubic feet (Davis factor of 61.64%). See Judge Rose R. 1260	12,260,196
Add: Leasehold cost of 502,319 wildcat acres at basis cost for 1923, or 83 cents per acre. Jirgal, R. 1161	458,425
Uebelacker's Valuation after making proper adjustments	$12,718,621

(8)—THE TESTIMONY OF PRACTICAL GAS MEN.

The apparent purpose of introducing Mr. Sullivan, Mr. Corrin, Mr. Gregory, Mr. Womack and Mr. David-

son was to attempt to establish a valuation of the leaseholds not based upon their gas content. It will appear from their testimony, however, that practically every one of them had some personal knowledge of the amount of gas which Mr. Davis estimated was in the ground.

These men were all associated with gas development companies and professed to be familiar with the price of gas lands in the market. Their positions in the gas industry were such, however, as peculiarly to affect their estimates of the value of the property of the United Fuel Gas Company. Mr. Sullivan and Mr. Corrin were each vice-presidents and executive officers of the Hope Natural Gas Company. (R. 280, 284.) Mr. Gregory was president of the Manufacturers' Heat & Light Company. The Hope Company is a large purchaser from the plaintiff. In 1923 it purchased 3,416,000 M. cubic feet. (R. 1134.) The Manufacturers' Heat & Light Company in turn buys from the Hope. (Gregory, R. 293.) In addition, both of these companies operate large gas fields in West Virginia, and the Hope, in particular, has extended its production system into territory adjacent to that of the plaintiff. Both companies are public utilities selling natural gas to domestic consumers at regulated prices. Mr. Womack was personally engaged in gas production in those counties where plaintiff's most extensive and valuable leases are situate (R. 303), and Mr. Davidson was directly associated with several companies whose chief business was the production of gas and the sale thereof to the plaintiff, the Hope and plaintiff's parent, The Columbia Gas & Electric Company. (R. 307.) Upon cross-examination before the District Court, he admitted that "there is a stipulation in his contract with the Columbia Gas and Electric Company that the price will be increased in the event of an increase allowed by the Public Service Commission for gas in the territory from which it is taken." (R. 317-318.) It is by no means difficult to see what the natural disposition of each of the gentlemen

naturally would be as to the value of the commodity in the production and marketing of which they are so vitally interested.

The values assigned by these witnesses to the gas rights of the plaintiff, can be justified only because they can resell such gas to their present consumers located at far away points, at a substantial profit.

It is a matter of common knowledge in the natural gas field that the farther the distribution systems are from the point of gas production, the higher the price which can be secured in the ultimate market. This is true because as the supply of gas becomes less and less, the markets which are farthest away are the first which must abandon the use of natural gas.

The secret of these excessive estimates lies in the fact that the basis of the judgment of every one of these witnesses was the present tremendous earning power of the plaintiff in existing public utility markets. The very nature of their business experience and the situations of the plaintiff and of the companies in which the witnesses were interested in the public utility business were all such as to render it a practical impossibility for them to disassociate the market value of gas from its value in the only business in which all of the companies in question are engaged. Mr. Sullivan (R. 282), Mr. Corrin (R. 288) and Mr. Gregory (R. 294) attempt to say that their estimates relate to value in an unregulated market. Reference to their various statements as to the factors considered by them demonstrates, however, that it was only the public utility demand and the earnings of the plaintiff in the public utility market which directly or indirectly gave the value to plaintiff's property concerning which they were testifying. Any other market existed only in speculation. That this is true is best supported by the record of their testimony, from which the following statements are illustrative.

"That by the fair value of the gas property he means that he thinks that the proven territory and the possible territory adjacent to the proven territory is worth that amount as a producing field for a gas company, considering what it could obtain for the gas, and the knowledge that he has of the operations and of the field enables him to put that value on it, excluding the wells themselves, that the gas could be sold, in his opinion, for such an amount as would give to those properties that value; that the cost of carrying the leases was not considered by him and is not an element in his estimate; that the price of gas considered by him in fixing his value upon said property was the *price said gas is selling for in the market today*." (Corrin, R. 288.)

That he saw the engineer's figures as to the amount of gas which would likely come out of the property, 663-billion cubic feet, but that his valuation *wasn't based entirely on that*." (Corrin, R. 289.)

That he had information as to the acreage, number of wells, amount of gas produced and sold from this territory during the last ten years, the selection of the acreage with reference to the possibility of marketing the gas in Pennsylvania and Ohio, the general demand for gas in those states and after considering all these varying different items he arrived at the value which he gave to the gas territory.

"That in his opinion the value of the gas reserves for natural gas purposes alone of the United Fuel Gas Company is in round figures $34,000,000, that that is what he considers a prudent purchaser who desired to buy the property ought to be willing to

pay to a willing seller therefor." (Sullivan, R. 281.)

"That the estimates of value which he has put upon the leaseholds of the gas reserves of United Fuel Gas Company are based largely upon the market for natural gas in Pittsburgh and in other territory adjacent thereto." (Gregory, R. 299.)

That his valuation was put "upon the theory that there was at a certain point and in a certain territory a demand for gas and that by reason of that demand or the necessities of the public utility that desired the gas they would be willing to pay cetain prices in order to get it and the value of the property is determined largely by the rate of which you are abe to sell the gas." (Gregory, R. 300.)

"That he could form an opinion of the value of this gas territory *based on what is received for gas*, which is one factor, and the demand for gas in the different fields, that in his judgment the gas territory owned by the United Fuel Gas Company, aside from the plant of the company—leaving that out of consideration—would be around $45,000,000." (Womack, R. 304.)

"That he arrived at the figure of 4½ cents per thousand cubic feet because he figured that it could be sold upon the basis of the value of 4½ cents per thousand cubic feet free of cost—in other words net cash, that he arrived at his figures by taking *the amount of gas that underlay these leases*, depleted that 45 per cent, and multiplied by 4½ cents, that he considers it worth the 4½ cents." (Davidson, R. 311.)

"That 4½ cents is what he considered the gas in the ground worth at the market price; that he never knew of any selling on that basis; that he considers it worth that." (Davidson, R. 312.)

"That in his opinion the gas is worth 4½ cents in the ground, and that in arriving at that he took into consideration the general trend of the market, having in mind the outside market, and speaking particularly of the market for the United Fuel Gas Company; that he believes that the United Fuel Gas Company could get that price for it over and above the cost to them—in other words, the cash basis for it to the *Hope, the Carnegie, or any of these companies.*" (Davidson, R. 314.)

It is manifest from the foregoing quotations that the value concerning which these witnesses spoke was a value induced by the demands and necessities of the public utility market. This is not inferentially, but expressly, shown by the statements of Gregory, (R. 300) and Davidson (R. 314), as well as by Corrin, (R. 288, 289). It is substantially borne out by Womack when he names the present price which is received for the gas and the demand in the various fields as the determinative value factors (R. 304), since the only current price and existing demand are those which result directly from the requirements of the natural gas utility business.

In the case of *Natural Gas Company of West Virginia v. Public Service Commission*, 95 W. Va. 557, 568, the State Supreme Court treated testimony similar to that presented here as follows:

"There are two objections to his testimony that we deem material. The first is that, while he may have been qualified as an expert witness, he does not sufficiently define the open market for these

leaseholds. The burden in this case is upon the company to establish its right to an increase. Section 9, ch. 15-0, Barnes' Code, 1923. The mere statement of the witness that the leaseholds are worth so much in the open market is not enough; he should have pointed out that market, defined it and explained its character. **Of course, if a natural gas public utility were the proposed purchaser, evidence of its offer would not be competent to show fair value in a rate case; and in like manner evidence of one whose valuation is based upon what he could obtain for the property when offered to a public utility would be incompetent; or if it is based upon the rate of return at the time of the offer or upon anticipated returns from the public it should be rejected.** Generally speaking, evidence of value in a rate-making case can not be based upon the rate of return or earnings of the utility, and whenever this appears, either directly or indirectly, such evidence is incompetent. It is almost inconceivable that there could be an open market for these gas leaseholds, situated as they are, which would not be based upon the rate at which the utilities there are selling gas to the public. While we held in *City of Charleston* v. *Public Service Commission*, 95 W. Va. 91, 120 S. E. 398, that in a rate case a utility is entitled to include in its present fair value, as a rate base, appreciation in the value of its leaseholds over investment cost, yet the evidence thereof must not be based upon, but must be independent of, the rates of return or earnings. Since the burden of showing the necessity or fairness of the proposed increase in rates is upon the company, a like burden is imposed upon it to show the value of its leaseholds

> over investment cost, as their value forms a component part of the rate base upon which the return is calculated. We hold, therefore, that a mere statement that they have a certain value in the open market is not sufficient; the party desiring to establish such value must by proper testimony show that it is independent of the rate of return or earnings of the company. Guided by this rule, the evidence in this respect is insufficient."

No doubt it was to meet just such criticism as the court there expressed that certain of the witnesses, despite the very obvious tenor of their whole testimony, attempted to say that in arriving at their estimates of value they had "in mind" an unregulated market, probably in Indiana, Ohio, the New York commercial market, or in the Pittsburgh industrial district. (R. 282, 288, 296.) Truly, these markets exist in the "mind." Of all the many conjectures upon which the different elements of plaintiff's case are founded none is more speculative than this undefined and unexplained market for plaintiff's gas supply, bounded on the east by some point in the state of New York, on the west by Indiana, and in all this wide domain theoretically free from embarrassing interference by the regulatory bodies of those states. All of these demands are to be supplied by the plaintiff, a corporation created and existing under the public utility laws of the State of West Virginia, which company has enjoyed the benefits of those laws since its organization. It involves the false theory of founding value upon earning, the "vicious circle" so frequently discredited by the courts.

The unreliability of these opinions as evidence of value appears forcibly from the testimony of Mr. Davidson. Mr. Davidson, before the Commission, testified that the gas holdings of the company were worth $39,000,000.00. (R. 309.) He was called as a witness for the plaintiff in

the hearing before the District Court. In the short time between these two hearings the Hope Natural Gas Company had entered the producing fields of the plaintiff. Davidson testified, because of this fact alone, his valuation before the Commission "should be reduced" twenty per cent." If the mere entry of one large competitor into the producing field of the plaintiff has such an effect upon the value of its acreage, it is interesting to consider what the effect would be if four or five of these large companies, who admittedly have an inadequate supply of gas, should enter the plaintiff's field. This goes to the question of whether plaintiff will be able to reduce to possession during the next eighteen years, the gas content assumed by Mr. Davis.

Plaintiff refers briefly to the testimony of Messrs. Cabot (R. 319), Sayre (R. 321), Ward (R. 323) and Grosscup (R. 323). These witnesses testified to contract prices ranging from 8 cents to 14 cents per thousand cubic feet for gas delivered to the purchaser either in the latter's pipe line or at the mouth of the well. Some of these contracts are the identical contracts referred to by Uebelacker in his valuation estimate (R. 198). The others are of the same character. All involve sales of small quantities of gas to purchasers conveniently located. It is reasonable to assume that they are the highest price contracts that could be found. Deducting the lifting costs, the average value of the gas in the ground based on the sales to which these witnesses refer could not be more than 5 cents, and as previously shown, in most instances would be about 3 cents per M cubic feet.

(G) PLAINTIFF'S EVIDENCE OF VALUE NOT UNCONTRADICTED

Plaintiff devotes a portion of its brief to the proposition that "there was an entire absence of any contradicting testimony" on the matter of the valuation of the gas rights.

This statement is not supported by the record. Mr. Hagenah's Exhibits Nos. 2, 3 and 4 (R. 1177-1216) deny the accuracy of the estimates of plaintiff's witnesses and their methods of valuation. Mr. Jirgal's testimony and exhibits, especially his exhibit No. 4, which shows the average cost of gas purchased, tend to refute Uebelacker's estimates of the value of the gas in the ground. The criticisms of both of these witnesses have been reflected in many parts of this brief.

Were plaintiff's proposition wholly true, however, it would not have the bearing which is attempted to be ascribed to it here. Opinions of witnesses as to such illusory matters are not analogous to testimony of observed facts which is usually accepted unless denied. Opinions on such questions need not be accepted by the Court. *The Conqueror*, 166 U. S. 110; *Wilcox v. Consolidated Gas Co.*, 212 U. S. 19.

> "Where factor in determination of whether electric rates amount to taking of company's property without just compensation involves prophecy, or rests on opinion evidence, neither commission or court is bound to accept absolutely either of conflicting views or opinion of single expert where but one testifies." (Decided April 28, 1927.)
>
> *Idaho Power Co. v. Thompson*, 19 Fed. (2d) 547.
>
> *Bluefield Tel. Co. v. P. S. Com.*, 102 W. Va. 296.

It is difficult to conceive a case where this principle has stronger application than to opinions as to the value of gas not yet discovered, and which if ever marketed must be sold over a long period of years.

Plaintiff in its brief here, as in the District Court, has charged the protestants with failure to produce practical

gas men to contradict the testimony of those examined by the plaintiff. The reason is obvious. All such experienced and practical sellers of gas are interested in securing the highest possible price for it; they are directly interested in securing an increase in rates for the plaintiff because this will result in an increase in the value of their product,—as was clearly brought out in the case of Mr. Davidson, who admitted that "there is a stipulation in his contract with the Columbia Gas & Electric Company that the price will be increased in the event of any increase allowed by the Public Service Commission for gas in the territory from which it is taken." (R. 317-8.) Hence no such witnesses were available to the protestants.

From a consideration of plaintiff's evidence we think that the following propositions relating to the valuation of plaintiff's gas rights are established:

1. That as the plaintiff has only a leasehold title or license as distinguished from a fee title or ownership, the leases must be valued as such and the amount of gas underneath such leases does not determine their value.

2. That gas being of a migratory and fugitive character, its presence underground cannot be considered in valuing leaseholds unless and until it is reduced to possession, or unless all uncertainties as to its being reduced to possession are removed.

3. That assumed markets for gas far distant from the location of plaintiff's property furnish no proper basis upon which to establish the fair values of leasehold rights.

4. That the price of a substitute product furnishes no basis upon which to establish the value of a property which has been dedicated to the public use.

5. That a public utility market for plaintiff's gas cannot be considered in determining the value of its gas

rights, for the reason that the public utility in that market has its rates regulated and the cost of the gas which it purchases from the plaintiff will control the rates which it is entitled to charge.

6. That in view of the nature of plaintiff's so-called leases, where the consumers pay the cost of carrying such leases as part of plaintiff's operating expense, they cannot be required to pay a return upon more than their actual cost.

7. That if plaintiff should be allowed to capitalize any increase in value of any part of its leases, the plaintiff and not the consumers must pay the carrying charges thereof.

(H) MEASURE OF APPRECIATED VALUE OF PLAINTIFF'S GAS RIGHTS

The Protestants contend that if this Court be of opinion that the Commission should have considered plaintiff's evidence of appreciation of its leasehold, and that such appreciated value should be reflected in the rate base, the amount thereof should be ascertained by the application of one or the other of the following methods:

(1.) Ascertain from the evidence the present day bonus cost of reproduction of the leases and add to such bonus cost of reproduction the present day carrying charges for the reasonable period found necessary to assemble all of these leases, and other expenses of assembling the leases. This method will give the best evidence of the cost of reproducing plaintiff's gas rights.

(2.) Sustitute in the operating expenses for the year 1923 the fair market price of the gas in the ground used in that year, and eliminate from such operating expenses any items which relate to the carrying costs of the acreage and from the rate base any items relating to its value.

STATEMENT SHOWING COST OF REPRODUCING ACREAGE
As of December 31, 1923

District	*County*	*Operated Acreage*	*Unoperated Acreage*	*Total Acreage*	*Bonus Cost of Reproduction Per Acre*	*Bonus Cost of Reproduction*
Union	Clay	1,838.12	14,643.26	16,481.38	$2.50	$ 41,203.45
Washington	Jackson	4,218.82	12,169.98	16,388.80	1.00	16,388.80
Cabin Creek	Kanawha	4,160.00	38,341.85	42,501.85	1.00	42,501.85
Big Sandy	Kanawha	10,420.43	36,354.89	46,775.32	4.50	210,488.94
Elk	Kanawha	4,896.50	21,253.14	26,149.64	1.75	45,761.87
Warfield	Mingo	1,459.00	7,591.87	9,050.87	1.00	9,050.87
Curtis	Roane	4,468.99	11,326.88	15,795.87	1.30	20,534.63
Geary	Roane	15,157.83	36,163.16	51,320.99	5.00	256,604.95
Smithfield	Roane	3,387.20	20,337.82	23,725.02	2.90	68,502.56
Spencer	Roane	3,556.76	11,160.84	14,717.60	1.00	14,717.60
Walton	Roane	7,590.57	15,568.95	23,159.52	5.00	115,797.60
Kentucky		4,315.50	105,470.75	109,786.25	.10	10,978.63
All others		3,431.00	405,142.97	408,573.97	.25	102,143.49
TOTAL		68,900.72	735,526.36	804,427.08	$1.18	$954,675.24

Assuming that it would take three years to acquire the total acreage owned by the company, there should be added—three times the delayed rental charges for 1923 (R. 1128) 1,885,570.47

—three times the leasehold expenses for 1923 (R. 1128) 146,570.47

Total cost of reproduction as of December 31, 1923 $2,986,351.56

(3.) If the Court considers that the fair market value of gas in the ground has been established, only the value of the gas in the *proven acreage* can be included in the rate base.

(4.) If the Court be of opinion to consider both "proven" and "probable" acreage, then it is necessary to ascertain what portion of this gas content valuation is presently used and useful.

(1)—COST OF REPRODUCING LEASEHOLDS:

Mr. Jirgal's testimony (R. 1088) shows the bonus cost of reproducing the acreage in the principal producing fields during the years 1921 to 1924, inclusive. By the application of these bonus costs to the total acreage leased by the company, a fair determination can be made of the cost of reproducing by the bonus payment plan the present acreage. As already indicated, in reproducing acreage considerable time would be required to assemble the various tracts and there would, therefore, necessarily be incurred considerable amounts for rentals and for leasehold expenses. This method of valuation affords evidence of the cost of reproducing that kind of property which the plaintiff actually owns, that is, leasehold rights to explore for gas. The cost of reproduction of the acreage on this basis would not be in excess of three million dollars ($3,000,000). This is shown by the following table based on "Jirgal Ex. No. 3".

Insert—Statement Showing Cost of Reproducing acreage

The value of the leaseholds, obtained by this method, is lower than the book cost for the reason that in placing the original valuation on these leases, the plaintiff disregarded the then costs of reproducing the leases or any cost of renewing the leases at that particular time.

(24)—GAS PURCHASED THEORY OF JUDGE ROSE

As this method has already been discussed under the same title, and as it has been developed in the opinion of Judge Rose (R. 1264), we do not think it necessary to do more at this point than to refer the court to these references. However, we wish to direct attention to Mr. Hagenah's Exhibits, Nos. 6, 6A, 7 and 7A (R. 1222-24), which show the results when this method is applied in the instant case. (See Insert.)

Class of Business	Cost of Reproduction Less Depreciation at Dec. 31, 1923**	Net Earnings Available for Depreciation and Return	Depreciation 5.5 Per cent of Book Cost of Property	Net Earnings Available For Return	Per Cent on Cost of Reproduction Less Depreciation
West Virginia:					
Charleston	$ 3,396,543	$ 651,356	$ 132,957*	$ 518,399	15.26
Huntington	2,556,555	275,830	101,034*	174,796	6.84***
Williamson	349,858	44,434	13,822*	30,612	8.75
Other West Virginia Towns	1,831,021	314,116	71,525*	242,591	13.25
TOTAL WEST VIRGINIA	$ 8,133,968	$1,285,736	$ 319,338*	$ 966,398	11.88
Kentucky	2,716,778	666,572	106,786*	559,786	20.60
Ohio	1,616,574	344,756	63,799*	280,957	17.38
Wholesale Service	15,491,850	3,120,116	607,084*	2,513,032	16.22
TOTAL GAS DEPARTMENT	$27,959,180	$5,417,180	$1,097,007	$4,320,173	15.45

*Red

**Covers Mr. Hagenah's value of physical property, going concern value and working capital, in fact all elements of value except leaseholds.

***Comparatively low return at Huntington is due to competition at Huntington hereinafter explained.

(3)—ONLY "PROVEN" ACREAGE TO BE CONSIDERED.

We submit that there can be no just claim by the plaintiff that it has been unfairly dealt with if the future supply of gas estimated to be in the "proven" territory is valued at the alleged 1923 fair market value in the ground of all such gas.

As stated, the Income Tax Department of the government has confined its determinations of discovery value in the case of natural gas deposits to "proven" territory defined in such way as practically to include what Mr. Davis has classed as proven territory for the purposes of this case. The District Court found that this proven territory was sufficient at the present rate of consumption to take care of plaintiff's entire business for five years in the future and to provide for its retail business in the state of West Virginia for over 20 years.

The record shows that the company purchased in 1923 over 9 billion cubic feet of gas from outside parties and that it drew from its own territory only 37 billion cubic feet. If this rate of purchase from outside parties is maintained at the rate obtaining for 1923, the gas supply in the proven territory would last nearly 7 years. All of the uncertainties as to whether this gas can be reduced to possession are of course not removed and the plaintiff is, therefore, being fairly dealt with if the Court should apply to the content in the proven acreage the fair market value of gas in the ground. Protestants claim that this fair market value is shown to be about 3 cents per thousand cubic feet, while plaintiff urges a value of 5 cents per thousand cubic feet. On these two bases the valuation of the gas in the proven territory would be as follows:

At 5 cents per thousand cubic feet (plaintiff	$12,455,000.00)
At 3 cents per thousand cubic feet (protestants	7,473,000.00)

Protestants contend that this method is far too favorable to the plaintiff because it does not consider the fact that the gas has not actually been reduced to possession. The consumer, therefore, will still speculate on the possibility as to whether the plaintiff will actually be able to raise the gas to the surface of the well.

(4)—PART OF PLAINTIFF'S GAS RESERVE PRESENTLY USED AND USEFUL

The solution of the valuation question outlined in the foregoing paragraph has added significance when it is considered in connection with Mr. Hagenah's estimate of the portion of plaintiff's gas rights presently used and useful in the utility business. His Exhibit No. 5 (R. 1555) is a masterly application of that principle to plaintiff's gas rights. As an engineer it is his belief that "the public interest will be adequately protected by a reserve sufficient to meet all reasonable requirements for 5 years in the future, and only such portion of the reserve should be included in the rate base at its fair present value." We ask the court's consideration of his diagram picturing the relation of this five-year supply to the entire reserve found at p. 1256 of the Record and explained at p. 1257.

At the present rate of production this method of valuation would closely approximate the value of the gas content of the proven territory as estimated by Mr. Davis, $10,317,311.39. For that reason, seemingly, it was this valuation of the proven territory which received the apparent approval of Judge Rose:

> "For the reasons already stated, we cannot see how any other portion of its gas can be held to be used in the public service, no matter how elastic a definition be given to the word 'used'. At the risk of tiresome repetition, we can say that we do not criticize plaintiff for acquiring any or all its gas

rights. It was doubtless wise to get them. All that we decide is that in arriving at the rate base upon which plaintiff is entitled to a fair return, we may not combine two opposing theories. We are not justified in saying that because plaintiff's investments in gas reserves were prudent, those reserves immediately went into use and that therefore plaintiff is entitled to have them appraised at the many times higher value it says they now have. If in dealing with its tangible property and going concern value, we are required to ignore, except for check purposes, plaintiff's investment in them, we must apply the same rule to its gas reserves.

If we are right, $10,812,311.39 is the highest valuation which can be put upon such portion of plaintiff's reserves as it has any claim to include in its rate base."

Plaintiff emphasizes the vision and foresight of its officers in assembling its large lease holdings, and the consequent advantage to the public. Protestants submit that there is little advantage to the public if it is to pay a return on the entire gas reserve of the plaintiff, part of which may not be used for many years. Mr. Hagenah forcibly pointed this out as follows:

"Where does the public gain in the slightest degree by the company going out and buying this gas land in the future if it must always pay for it on the basis of its gained value as determined by competitive conditions by the exchange method. The public would gain by the fact that it had the gas, but it would pay a price for it purely determined by the monopoly power."

(R. 446.)

Plaintiff argues (Plaintiff's Brief, p. 54, 64) that if only the presently used and useful portion of the gas reserves be included in the rate base that an annual amortization rate sufficient to amortize *all of its property* (including physical property) in five years must be allowed. This argument indicates a misapprehension of the District Court's position (R. 1264) and that of protestants as presented by Hagenah. Mr. Hagenah (R. 444, 1216-1221) accepted for the purpose of his analysis the eighteen-year estimated life of the field as determined by Davis, but was of opinion that *only a five-year supply* of this total eighteen-year gas content was presently used and useful. He contemplated the depreciation and amortization of the property on the basis of at least eighteen years, and that the total appraised value of the gas reserves, (assuming the "market value" to be the proper basis), would ultimately be absorbed in the cost of gas by each year adding to the used and useful reserve an appropriate amount to offset the reduction of such supply for the year just closed. On this basis, the five-year supply was moved forward and kept undiminished each year until the entire supply had been consumed. This does not mean that the physical property used in transporting and distributing the gas over the eighteen-year period is to be depreciated and amortized on a five-year life basis. The plaintiff would find little incentive to dispose of its leases acquired at probably one-half of their present reported "book cost" and abandon a very valuable physical plant, at the end of five years, when it can always secure a fair return on five-eighteenths of the "present value" of such leases.

Commissioner Divine fixed $10,500,000, approximately the same amount as was found by Judge Rose, for the value of the leases upon consideration of all of the evidences of value in the case. (R. 136.)

On the basis of Mr. Hagenah's calculations, the value of the gas reserves (based on $33,000,000 valuation of

Mr. Uebelacker) by the two methods explained by him are as follows:

Using 5/18 of the appraised value and 13/18 of the book cost	$14,005,554
Using only 5/18 of the appraised value	9,160,667

This limiting of capitalizing appreciation of gas reserves to only such part thereof as is presently used and useful is sustained by the City of Erie case, cited and relied on by plaintiff, where the Supreme Court of Pennsylvania held:

> "Gas holdings should be included and valued for rate-fixing purposes only to the extent that they represent **developed, used, and useful territory**, including a reasonable reserve for the continued functioning of the company in the public service."
>
> *City of Erie v. P. S. C.*, 228 Pa. 512, 132 Atl. 471, 478 (Syl. 11).
>
> *Re Plainfield Union Water Co.* (N. J.) P. U. R. 1924 D 300.

I—BOOK COST OF PLAINTIFF'S ACREAGE

In other parts of this brief we have shown that "book cost" as herein used is not book cost, but the inflated valuation of the leases carried upon plaintiff's books. This value on December 31, 1923, was $6,343,329.67 (R. 117). Jirgal's Exhibit No. 3, page 11, shows that the leasehold expenses and carrying charges in the form of rentals on unoperated acreage have aggregated $7,126,454.00 since 1908 (R. 1091). These large amounts have been included in the expenses on which the existing schedule of rates is founded. To include in operating expense the rentals on the unoperated acreage and the leasehold expenses was shown by Mr. Jirgal to be equivalent to allowing on an 8 per cent capitalization basis an added value to the company of $7,360,000.00. Thus, when the Commission accepts

the "book cost" of the gas reserves as the best evidence of their present value and makes no adjustment in the operating expenses to cover all carrying charges, the company is in fact benefited by the equivalent of applying the rate of return to the sum of these two items, or $13,703,329.67, as follows:

Book value of acreage December 31, 1923	$6,343,329.67
Carrying charges and expenses of $589,186.00 for 1923 capitalized on an 8 per cent basis	7,360,000.00
	$13,703,329.67

Summary

The following is a summary of the methods of valuation discussed above in sections H and I:

Book Cost of Acreage (R. 1071 and 1154)	$ 6,732,920
Book Cost after Excluding oil Acreage (R. 1072, R. 117)	6,343,329
Cost of Reproducing Leases on Basis of Prevailing Bonus Payments and Lease Rentals, etc. in 1923 about	3,000,000
Value of gas in Proven Territory at 5c per M cubic feet in the ground	12,455,000
Value of gas in Proven Territory at 3c per M cubic feet in the ground	7,473,000
Value of 5/18 of Total at appreciated Value of $33,000,000 and 13/18 at book cost as representing presently used and useful property	14,005,554
Value of only 5/18 of Total at appreciated Value of $33,000,000 as representing presently used and useful property	9,166,667
Appreciated Book Cost of leases on same basis as increase in prices of other commodities (Hagenah, R. 485)	9,495,920

13.18 at Book Cost as representing Presently Used and Useful Property	24,000,000	960,000	3,000,000	14,005,554	41,995,554
Value at only 5/18 of Total at Appreciated Value of $33,000,000 as representing Presently Used and Useful Property	24,000,000	960,000	3,000,000	9,166,667	37,156,667
Appreciated Book Cost of Lease on Same Basis as Increase in Prices of Other Commodities (Hagenah, R. 485)	24,000,000	960,000	3,000,000	9,405,920	37,405,920

*This basis gives no weight to original cost of physical property which as shown is entitled to considerable weight because such a large part of the property was built during the period of high prices. Original cost to December 31, 1923, was $19,945,582. Using original cost as a basis would give a fair valuation of about $4,000,000 less in each of the above cases.

SUMMARY OF VALUATION OF PLAINTIFF'S PROPERTY INCLUDING DIFFERENT VALUATIONS OF LEASES AS SHOWN BY PROTESTANT'S WITNESSES

Basis Assumed for Valuing Gas rights	Maximum Fair Value of Physical Property (Hagenah R 486)*	Required Working Capital Agreed on by Parties	Going Concern Value—Not Disputed in Bill of Complaint	Value of Leaseholds on Various on Various Bases Discussed Above	Total Fair Value of Plaintiff's Property on each of Foregoing Bases
Book Cost of Acreage (R 1071 and 1154)	$24,000,000	$ 990,000	$3,000,000	$ 6,732,920	$34,722,920
Book Cost after Excluding Oil Acreage (R 1071)	24,000,000	990,000	3,000,000	6,343,329	34,333,329
Cost of Reproducing Leases on Basis of Prevailing Bonus Payments and Lease Rentals, etc. in 1923 about	24,000,000	990,000	3,000,000	3,000,000	30,990,000
Value Gas in Proven Territory at 5c per M Cubic Feet in the Ground	24,000,000	990,000	3,000,000	12,455,000	40,445,000
Value Gas in Proven Territory at 3c per M Cubic Feet in the Ground	24,000,000	990,000	3,000,000	7,473,000	35,463,000
Value 5/8ths of Total at Appreciated Value of $ [illegible] and					

Protestants contend that the Commission was entirely right in finding that the book cost was the only reliable evidence of the value of the gas rights, but that even if this be not true, a finding of value, taking into consideration the appreciation element, of more than $10,500,000 would not be warranted on the basis of plaintiff's evidence. This is in substance the finding of the District Court.

VIII.—NO CONFISCATION UNDER ANY VIEW OF THE EVIDENCE

At the outset of this brief, protestants undertook to show that no confiscation could exist in the present case if the fair value of the property was found to be no higher than the valuation which would be arrived at by capitalizing the net earnings under existing rates at a reasonable rate of return. We think it has appeared from the evidence that the fair value cannot possibly exceed the valuation arrived at on these capitalization bases and that no higher fair value can be found for plaintiff's property than the amounts already found by the Public Service Commission. Certainly, the fair value cannot exceed the amount set forth in the opinion of the District Court.

That the latter contention is sound will appear, we think, from the following table in summary of the valuation problem

We again compare the value of plaintiff's property arrived at by the capitalization method with the fair value arrived at by the Commission and the Courts

	Value arrived at by Capitalizing on Percentages found reasonable for Return, or for Return Amortization and Depreciation	*Determined Fair Value*
1 By Chairman Stathers Public Service Commission of West Virginia	$67,000,000.00*	$35,999,969.14
2 By Commissioner Divine District Court for Southern District of West Virginia	65,000,000.00*	40,165,000.00
3 On basis of Adjusting Parent Company rates to comparable wholesale rates	58,858,872.27**	40,307,311.39
4 On Basis of Adjusting Parent Company rates to rates comparable with those applying to West Virginia retail consumers	53,295,228.84**	40,307,311.39
5 Same as 3 except delay rentals are deducted from operating expenses	63,900,000.00***	40,307,311.39
6 Same as 4 except delay rentals are deducted fro operating expenses	58,300,000.00***	40,308,311.39

*Arrived at by capitalizing net earnings at 8%

**See Judge Rose's Opinion (R. 1239)

***Approximately $5,000,000 added—See Judge Rose's Opinion (R. 1271 and 1272)

The facts appearing from this table demonstrate, we think, there is no confiscation of plaintiff's property under its existing rates

IX—COMMISSION'S JURISDICTION OF PLAINTIFF'S WHOLESALE BUSINESS

Protestants deny plaintiff's argument that the Commission has no jurisdiction to regulate the rates which plaintiff charges the public utilities purchasing from it

> *Clarksburg L. & H. Co. v. Pub. Ser. Com.*, 84 W. Va. 638

We submit, however, that this court is not concerned with that question. The plaintiff is not the proper person to complain of discrimination between its different consumers. If its business yields a fair return there can be no confiscation.

> "Where none of the different classes of consumers complain of different rates the corporation can not complain of such differences provided the total receipts are sufficient to yield an adequate return."
> *Willcox v. Consolidated Gas Co.*, 212 U. S. 19
> *Pittsburgh & W. Va. Gas Co. v. P. S. C.*, 101 W. Va. 63

X—RETURN FROM WEST VIRGINIA RETAIL BUSINESS

It is not difficult to determine from the evidence the operating results from West Virginia retail business. The bases of apportioning the property values and the operating revenues and expenses have been laid down by the Commission for a great many years and have been uniformly applied in the cases which the plaintiff has brought before the Public Service Commission. In general, these bases or principles are as follows:

> 1. That the revenues of the company shall be assigned directly to each class of business. This can be accurately done from the company's records.

2. That all items of expense and property value which relate to the production system shall be divided between each class of business on the basis of the number of cubic feet of gas sold to such class of business.

3. That all items of expense and property value which relate to the transmission system shall be assigned to the various classes of business on the basis of the demand-mileage. In other words, this basis is the composite arrived at by multiplying the contribution made to the system maximum demand in the case of each class of service by its distance from the center of the field. The transmission investment is of course determined by two factors, to-wit, volume of gas which flows through the pipes at the time of the maximum demand on the system and the number of miles of pipe which it is necessary to lay in order to reach the point of delivery for each class of business.

4. All items relating to the value of the distribution plant and the expense of its operating shall be directly assigned to the class of business served by such distribution systems. This can be done directly in the case of the several valuations and in the case of the company's records. The wholesale business is not burdened in any way with the value of the distribution system nor its operating expenses.

5. The small amount of general property and general operating expenses which are incidental to the business are distributed on the so-called overhead basis, that is, in proportion to the results arrived at by a combination of the allocation bases referred to above.

We understand that counsel for the plaintiff approve these bases of apportionment. They were approved by the District Court (R. 1270).

The table on ~~the opposite~~ page shows that the net earnings (after deducting for depreciation and amortization) applicable to the State of West Virginia, were $1,333,329. (Jirgal "Exhibit 3 J. C. No 1"—R. 1161.) Except for a minor adjustment of $11,780, representing border line sales, Judge Rose accepted these net earnings down to the point of the deductions for depreciation and amortization. (R. 1271.) The adjustment for parent company sales has no influence on the results for West Virginia retail business and Jirgal made no such adjustment in arriving at net earnings from that business.

The figure of $881,989 represents that portion of the whole sum of $1,399,227, allocable to the West Virginia retail business for depreciation and amortization. (Jirgal "Ex. 3 J. C. No 1", 1161.) While the sum of $1,399,227 is arrived at by applying the Commission's allowance to the original investment, (which we insist is the correct method), we think it has been sufficiently demonstrated that it is ample though this court should reject protestants' view that amortization is to preserve the company's investment intact and should apply the percentage allowance to present value. (Ante, p. 54.)

If to the earnings of $1,333,329 the delay rentals ($147,945) be added back and the total be capitalized at 8 per cent, the valuation, for the West Virginia retail business is $16,700,000.

We submit that no confiscation exists if the fair value arrived at by the Commission or the District Court assignable to the West Virginia business is not more than $16,700,000, regardless of such errors, if any, as may have entered into their findings as to the rate base.

The District Court found the fair value, even considering the appreciation in the leaseholds assignable to West Virginia to be only $11,251,399. (R. 1273.) This figure includes the full appreciated value of all of the leases assignable to West Virginia business which can be proper-

ly considered as used in the public service (R. 1264). It is in line with Commissioner Divine's figure of $10,500,000 as the total value of the leases. The fair value of plaintiff's property arrived at by capitalizing its earnings assignable to West Virginia retail business is therefore far greater than the fair value assigned by the District Court. It is nearly $2,000,000 greater than the amount assumed as the value of the plaintiff's property "used and useful" in West Virginia ($14,940,980) at page 62 of appellant's brief which includes the appreciated value of its leaseholds as alleged in its bill.

The evidence on the net earnings assignable to the West Virginia retail business is summarized in the following statement:

	Judge Rose R. 1271	*Mr. Jirgal Per Exhibit 3 J. C. No. 1 R. 1161*	*Difference*
Gross Earnings	$2,307,051	$2,318,831	$ 11,780
Proportion of Gasoline Extraction Credit	234,626	234,626	-------
Total Gross Income	$2,541,677	$2,553,457	$ 11,780
Operating Expenses and Taxes	986,084	986,084	-------
Net Earnings before Depreciation and Amortization but after Deducting Delay Rentals	$1,555,593	$1,567,373	$ 11,780
Deduct—Depreciation and Amortization Computed on Original Cost		381,989	
Net Earnings before Adding back Delay Rentals and Leasehold Expense		$1,185,384	
Add Back—Delay Rentals and Leasehold Expense		147,945	
Net Earnings available for Return		$1,333,329	

In lieu of Jirgal's allowance of $381,989 for amortization and depreciation, Judge Rose deducted from his net earnings of $1,555,593 the item of depreciation assignable to West Virginia amounting to $113,658 and arrived at $1,441,935 as the earnings applicable to return and amortization. Using a capitalization factor of 11.65 per cent to cover these two elements he arrives at an effective fair value of $12,377,124 (R. 1272), an amount more than $1,000,000 in excess of the value found by him. He questions the allowance of delay rentals amounting to $147,945 as an operating charge, and shows that if they were added back to the net earnings, as protestants claim they should be, they would add an additional $1,000,000 to this effective fair value. Without discussing the question, Judge Rose by using a composite percentage for fair return and amortization, in effect adopted fair value as the correct basis for computing the annual allowance to cover amortization. Protestants contend that the original investment is the proper basis and that the proper net earnings to capitalize at 8%, are shown to be $1,333,329.

In order that the Court may have before it evidence of value for West Virginia similar to that which it has for the property as a whole, there is reproduced below the allocation of the physical property, working capital, and going concern value for each of the witnesses testifying in this case. For the purpose of this statement going concern value has been taken at $3,000,000 as the evidence shows that no higher amount is justified.

(See insert. Statement showing Allocation to West Virginia of Physical Property Values, Working Capital and Going Concern Value.)

On the basis of this statement it would appear that no higher value than that shown by Hagenah, $8,134,874, should be allowed as the proportion of the three items of physical property, working capital, and going concern

STATEMENT SHOWING ALLOCATIONS TO WEST VIRGINIA OF PHYSICAL PROPERTY VALUES, WORKING

Particulars	Basis of Apportionment	Cost of Reproduction New Less Depreciation		Historical Cost As	Original Cost As
		As Found By Mr Ubelacker	As Found By Mr. Hagenah	Found By Mr Ubelacker	Found By Mr. Jirgal
Production system (Exclusive of leaseholds	Sales (25.11%)	$1,966,213	$1,855,602	$2,224,233	$2,113,107
Transmission system	System demand mileage (20.72%)	2,311,176	2,012,616	1,914,131	1,931,377
Distribution system	100% of property actually located in West Virginia	1,915,322	1,878,260	1,587,456	1,506,236
General property	Overhead on property	169,858	167,797	89,938	34,044
Total specific cost		$6,362,569	$5,914,275	$5,815,758	$5,584,764
General overhead charges	Overhead on property	1,815,572	1,064,573	1,253,600	
Total reproduction cost less depreciation (Exclusive of leaseholds)		$8,178,141	$6,978,848	$7,069,358	$5,584,764
Working capital	Overhead on expenses	282,546	282,546	282,546	282,546
Going concern value	Overhead on property	856,800	873,480	845,250	840,000
Total above items		$9,317,487	$8,134,874	$8,197,154	$6,707,310
Per cent allocated to West Virginia		28.56%	29.10%	28.19%	28.02%

devoted to the West Virginia retail business. By rounding out, in the interest of easy computation, Hagenah's estimate for the reproduction cost less depreciation at $24,000,000, the amount for West Virginia, for the particular three items mentioned, becomes $8,143,866, as will presently appear.

The protestants in this case claim that the maximum fair value of the physical property is only $24,000,000. Chairman Stathers set the value of the physical property at $25,000,000, and the District Court held that such fair value was not in excess of $26,000,000. In order that the Court may have before it the total amount assignable to West Virginia in the case of the three items of physical property, working capital, and going concern value, there is given below such total on each of these bases.

STATEMENT SHOWING ALLOCATION TO WEST VIRGINIA OF PHYSICAL PROPERTY VALUES, WORKING CAPITAL AND GOING CONCERN VALUE, WHEN PHYSICAL PROPERTY IS VALUED AT $24,000,000, $25,000,000 AND $26,000,000

Particulars	*Physical Property*	*Working Capital*	*Going Concern Values*	*Total*
On basis of $24,000,000 physical property	$6,987,840	$282,546	$873,480	$8,143,866
On basis of $25,000,000 physical property	7,279,000	282,546	873,480	8,435,026
On basis of $26,000,000 physical property	7,570,160	282,546	873,480	8,726,186

STATEMENT SHOWING TOTAL VALUE ASSIGNABLE TO WE
SEVERAL BASES HERETOFORE DISCUSSED.

Basis Assumed for Valuing Gas Rights	*Maximum Fair Value of Physical Property (Hagenah, R. 486)*	*Requi Work Capi Agre on b Part*
Book cost of acreage, R. 1071 and 1154	$6,987,840	$282,5
Book cost after excluding oil acreage, R. 1071	6,987,840	282,5
Cost of reproducing leases on basis of prevailing bonus payments and lease rentals, etc. in 1923—about	6,987,840	282,5
Value of gas in proven territory at 5c per M cubic feet in the ground	6,987,840	282,5
Value of gas in proven territory at 3c per M cubic feet in the ground	6,987,840	282,5
Value at 5/18 of total at appreciated value of $33,000,000 and 13/18 at book cost as representing presently used and useful property	6,987,840	282,5
Value at only 5/18 of total at appreciated value of $33,000,000 as representing presently used and useful property	6,987,840	282,5
Appreciated book cost of leases on same basis as increase in prices of other commodities (Hagenah, R. 485)	6,987,840	282,5

VIRGINIA WHEN LEASEHOLDS ARE VALUED ON EACH OF THE

	Going Concern Value—Not Disputed in Bill of Complaint	*Total Foregoing*	*Value of Leaseholds on Various Bases Discussed Herein*	*Total Fair Value of Plaintiff's Property on Each of Foregoing Bases*
6	$873,480	$8,143,866	$1,690,636	$ 9,834,502
6	873,480	8,143,866	1,592,810	9,736,676
5	873,480	8,143,866	753,300	8,897,166
5	873,480	8,143,866	3,127,451	11,271,317
5	873,480	8,143,866	1,876,470	10,020,336
5	873,480	8,143,866	3,516,795	11,660,661
5	873,480	8,143,866	2,301,750	10,445,616
4	873,480	8,143,866	2,384,426	10,528,292

If the various estimates of leasehold values heretofore discussed are allocated to West Virginia on a sales basis —which is conceded to be proper by all parties—the following results obtain.

STATEMENT OF ALLOCATIONS TO WEST VIRGINIA OF VALUE OF LEASEHOLDS ARRIVED AT ON VARIOUS BASES. *(Sales basis of allocation used, 25.11%.)*

Particulars	*Amount*
Book cost of acreage, R. 1071 and 1154	$1,690,636
Book cost after excluding oil acreage, R. 1071	1,592,810
Cost of reproducing leases on basis of prevailing payments and lease rentals, etc. in 1923 about	753,300
Value of gas in proven territory at 5c per M cubic feet in the ground	3,127,451
Value of gas in proven territory at 3c per M cubic feet in the ground	1,876,470
Value of 5.18 of total at appreciated value of $33,000,000 and 13.18 at book cost as representing presently used and useful property	3,516,795
Value only of 5.18 of total at appreciated value of $33,000,000 as representing presently used and useful property	2,301,750
Appreciated book cost of leases on same basis as increase in prices of other commodities (Hagenah, R. 485)	2,384,426

Accepting a maximum fair value of $24,000,000 for physical property, $900,000 for working capital, and $3,000,000 for going concern value, it is now possible to determine the total fair value for that portion of applicant's property which is devoted to the retail business in West Virginia. This is done for each method of estimating leasehold values in the following statement.

INSERT. Statement showing total value assignable to West Virginia when leaseholds are valued on each of the several bases heretofore discussed.

It will be noted that even on a most favorable basis of valuing gas leaseholds a total value of only $11,000,661 is assignable to West Virginia. It has already been shown that if the earnings applicable to West Virginia retail business are capitalized on the basis of a reasonable return of 8%, the effective fair value for West Virginia retail business would be $16,700,000. This amount is fully $5,000,000 in excess of any fair value which could be arrived at by considering the separate elements.

Plaintiff in its brief has prepared tables to show its view of the earnings necessary for the West Virginia business (p. 62) and of the rate base allocable to that business (p. 64). Both studies are premised upon the inclusion in the rate base of a leasehold valuation of $30,000,000, and for that reason are challenged by protestants. Aside from this fundamental objection, there are certain errors which are apparent even upon plaintiff's view of the case.

Plaintiff states (p. 62) that Uebelacker found the gross earnings for 1923 to be $2,155,475. This is true. Mr. Uebelacker included only the revenue from the *cities* of West Virginia (Hightower "Exhibit No. 5", R. 9961). Had he included rural and field sales, his total would have been $2,318,831 (Jirgal, R. 10671). In the same table plaintiff further errs in making a double deduction for depreciation to its own advantage. In arriving at the figure of $1,441,935, Judge Rose had deducted $113,658 for depreciation, yet in computing its figure of $1,804,175 plaintiff includes $72,548 for depreciation. Even accepting plaintiff's theory of the case, its figure of $1,804,175 is not properly comparable to Judge Rose's $1,441,935.

A significant result obtains if there be added to Judge Rose's figure of $1,441,935 the delay rentals of $147,945, and the whole ($1,589,880) be capitalized at 11.65 per cent, the percentage allowed by the District Court for return and amortization. An effective fair value of $13,547,034 for West Virginia retail business is indicated. Deduct-

ing $8,143,866 for physical property, going value and working capital (Ante, p. 180) there remains $5,503,168 for gas rights allocable to West Virginia business. Using Mr. Uebelacker's apportionment of 25 per cent (Plaintiff's brief, p. 62) of the property value for West Virginia, there results as a total valuation for plaintiff's leaseholds the sum of $23,455,548. This valuation includes but two adjustments, one for gasoline earnings, the other, the crediting of delay rental charges to earnings. Neither parent company sales nor depreciation on the basis of original cost enters into this amount. It is more than twice the value arrived at by Commissioner Divine and the District Court and nearly four times the book cost. Stating this in another way, the total property valuation on this basis would have been as follows:

Physical property	$24,000,000
Working capital	990,000
Going concern value	3,000,000
Leaseholds	22,012,772
	$50,002,772

Protestants, of course, reject any such valuation as $50,000,000 as grossly excessive. The present earnings of the plaintiff, however, with but two adjustments, gasoline earnings and the charging back of delay rentals, sustain that valuation.

The table at page 65 of plaintiff's brief condemns itself. It purports to demonstrate that the retail earnings in West Virginia are inadequate, though only a five years' supply of gas is included in the rate base. The methods used are founded upon plaintiff's misconception of the "used and useful" theory of valuing the gas acreage. To amortize $9,793,486 worth of property at the rate of 18.46 per cent per annum, as provided by plaintiff's figures, means the amortization of all of its capital, including

physical plant within five years. No such conclusion follows from the inclusion of merely the "used and useful" portion of the gas reserves in the rate base. (See discussion, ante, p. 167-168.) A revision of plaintiff's table more nearly representing its theory of the case follows:

Depreciation, 1.12% of $6,477,476 (Physical property)	$ 72,548
Return, 8% of $10,039,996	803,200
Amortization of *present value* of leases, 18.46% of $2,569,010	474,239
Amortization of *present value of physical* plant 3.65% of $6,477,476	236,427
Total minimum sum which appellant must earn for depreciation, amortization and return	$1,586,414

The necessary earnings thus arrived at are approximately the same as those which the District Court found the plaintiff was actually receiving, even before adding back delay rentals.

Still further revising the above table so as to amortize the *investment* in the leases and physical property assignable to West Virginia, the result is as follows:

Depreciation 1.12% of $6,477,476	$ 72,548.00
Return, 8% of $10,039,996	803,200.00
Amortization of 5/18 of book cost of leases (18.46% of $469,621)	86,692.00
Amortization of book cost of physical plant (3.65% of book cost plus 1924 additions)	186,649.00
Total minimum sum which appellant must earn for depreciation, amortization and return	**$1,149,089.00**

The plaintiff in this case leaves the inference with the Court that the retail rates in the State of West Virginia are out of line with its wholesale rates. Nothing is further from the fact. The reason the plaintiff has come to this erroneous conclusion is that it has compared the average rate per thousand cubic feet received in West Virginia with the average rate received from its wholesale business (exclusive of the rates to its parent companies). The reason it is not proper to use the average retail rate received for gas in the State of West Virginia in making this comparison is because many of the communities served by the plaintiff are located close to the production field and therefore the cost of supplying them is very much less than the cost of supplying the majority of the wholesale users, the points of delivery to which are farther removed from the center of the field. A large proportion of the total retail sales in West Virginia are made in the field or so close to the fields as to involve practically no transportation costs.

The true test to be used in determining whether West Virginia retail consumers contribute to the aggregate profits of the company their just share is to be found in the percentage which is earned on the investment properly allocable to that state as compared with the percentage earned for the property as a whole. The application of this test can easily be made. For this purpose, it is best to use Mr. Jirgal's exhibits although they relate only to the book cost. The reason this can be done is because the appreciation in property values is distributed equally and proportionately throughout the property, whether it is located in West Virginia or elsewhere. In view of the fact that we are interested only in relative profitableness of various sections of plaintiff's business, it is therefore possible to use book cost as well as any other basis of valuation in the demonstration.

Jirgal shows at R. 1067 that the plaintiff earned on its wholesale business only 11.93 per cent for depreciation,

amortization and return on investment in the year 192
This is considerably lower than the percentage earned fo
return, depreciation and amortization in the West Virgini
retail business which was shown to be 18.93 per cen
However, it has already been shown that the two parer
companies of the plaintiff do not pay a proper price fo
their gas supply and if the adjustment is made along th
lines contended for by the protestants, the wholesale bus
ness including the revenue resulting from the adjustmer
would yield for return, depreciation and amortizatio
21.32 per cent as shown by Jirgal's calculations

On the basis of the company's own records therefore, th
wholesale business contributes much less to the total busi
ness of the company than does the West Virginia retai
business. Using plaintiff's line of reasoning it woul
appear that it was seeking to make up in West Virgini
retail rates its failure to require the wholesale business t
pay its way. In other words if the parent companies pai
their share of the total necessary earnings there would b
no need to increase the rates to West Virginia retail con
sumers. But even if an adjustment for the parent compan
sales is made, there is only a slight differential in favo
of the wholesale business as against the West Virgini
retail business. This small differential is explained not b
the unreasonableness of any rates applied to the retai
business in West Virginia but is due to the fact that i
the largest community served by the palintiff in this state
it is required to compete with another natural gas distrib
uting company, The Huntington Development & Gas Com
pany (R. 353). This competition at Huntington has bee
repeatedly referred to by the commission in its decisions
and is discussed in plaintiff's first application for an in
crease, *In Re United Fuel Gas Co.* 1 P. S. C. of W. Va
Dec. 238 (1916) also in its case No. 585, 1 P. S. C. o
W. Va., Dec. 501. Jirgal shows in his Exhibit No. 1
(Record, page 1068) that the plaintiff earns in the city o

Huntington only about two-thirds of what it earns in the balance of the state. The effect of this competition is very clearly shown by the fact that the average rate for the city of Huntington is about the same as it is for the city of Charleston, although Huntington is located more than 40 miles farther from the center of the field than is Charleston. Over one-third of the plaintiff's investment assignable to the State of West Virginia is attributable to Huntington business so that the effect of this competitive situation on the total West Virginia business must necessarily be marked.

Bearing in mind that after adjusting the sales to the parent company the plaintiff earns from its wholesale business 21.32 per cent for return, depreciation and amortization, we find that there is practically no difference between the profitableness of West Virginia retail business which is regulated and the wholesale business of the plaintiff which up to this time has been a matter of free contract.

XI.—CONCLUSION.

To summarize the points discussed in this brief, we submit

1. That in passing upon the issue of confiscation in this case the Court is primarily concerned not with the fair value specifically found by the Commission and the Court, but with that valuation which results from capitalizing plaintiff's net earnings on the basis of a reasonable return. Such capitalization results in a valuation far in excess of the specific findings of fair value of the Commission and the Court.

2. That the Commission did not err in finding too low a fair value for plaintiff's property and that such finding is fully supported by the evidence in this case. Further, this finding by the Commission is so much less than the effective fair value resulting from capitalizing the existing rates that no ground for confiscation is shown.

3. That in ascertaining the net earnings of the plaintiff for the purpose of applying the capitalization basis, the Commission was clearly right in making adjustments for the gasoline extraction privilege, and for the sales of gas to the parent companies, but it erred in allowing too large an amount for depreciation and amortization, and if appreciation of leaseholds over investment cost is to be considered, it should have excluded from the operating expenses the amount of delay rentals and leasehold expenses.

4. That upon all the evidence, there is no showing of confiscation upon a consideration either of plaintiff's business as a whole or of only its retail business in the State of West Virginia.

The fact that plaintiff's earnings when capitalized at 8% produce a fair value far in excess of that found by the Commission or the Court, approximately equal to that claimed by the plaintiff and substantially larger, we submit, than any valuation which can be sustained by the evidence, makes peculiarly appropriate the language of this Court as to the view to be taken of such confiscation cases.

> "In a case like this we do not feel bound to re-examine and weigh all the evidence, although we have done so, or to proceed according to our independent opinion as to what were proper rates. It is enough if we can not say that it was impossible for a fair-minded board to come to the result which was reached."
>
> *San Diego Land & Town Co. v. Jasper*, 189 U. S. 439.

The decree of the District Court should be affirmed.

Respectfully submitted,

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Appellees.

November 18, 1927.